Supreme Court, U.S.
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No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

TOSHIBA AMERICA MEDICAL SYSTEMS, INC.,

Petitioner,

vs.

OEC MEDICAL SYSTEMS, INC.,
formerly known as Diasonics, Inc.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEAL OF CALIFORNIA, FIRST DISTRICT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether federal law governs the review of, and thereby establishes a nationwide uniform standard to review, an arbitral award entered in a Federal Arbitration Act arbitration or, instead, as the court below held, state law establishes the standard of review whenever the underlying contract contains a governing law clause?

2. Whether the Full Faith and Credit Clause, U.S. CONST. art. IV, §1 and the Due Process Clause, U.S. CONST., amends. V and XIV, require the courts of a state in which an arbitration sits to yield to its sister states' public policies, when those sister states have greater governmental interests as concerns the underlying events?

LIST OF PARTIES

The parties to the proceedings below were the petitioner, Toshiba America Medical Systems, Inc., and the respondent OEC Medical Systems, Inc., formerly known as Diasonics, Inc.

Toshiba America Medical Systems, Inc. is ultimately, indirectly owned by Toshiba Corporation, a publicly-held corporation. OEC Medical Systems, Inc. is a publicly-held corporation.

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ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEAL OF CALIFORNIA, FIRST DISTRICT

PETITION FOR A WRIT OF CERTIORARI

Petitioner, Toshiba America Medical Systems, Inc. ("Toshiba America") respectfully prays for a Writ of Certiorari to review the judgment of the Court of Appeal of California, First District.

OPINIONS BELOW

The decision of the Supreme Court of the State of California denying Toshiba America's Petition for Review is not reported and is reprinted as Appendix A. The Opinion of the Court of Appeal, First District, First Division, State of California is not reported and is reprinted as Appendix B. The Judgment of the Superior Court, County of San Francisco,

State of California is not reported and is reprinted as Appendix C. The Arbitration Award is reprinted as Appendix D.

JURISDICTION

The Court of Appeal, First District, First Division, entered its judgment on October 25, 1995. Petitioner timely petitioned the Supreme Court of the State of California, which is the state court of last resort and which had discretionary authority to review the judgment, for review of the judgment. That court denied Toshiba America's Petition for Review on January 30, 1996. This petition is timely filed within ninety days of that denial. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. §1257.

CONSTITUTIONAL PROVISIONS INVOLVED

Article IV, Section 1 of the United States Constitution provides in pertinent part:

> Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State.

The Fifth Amendment to the United States Constitution provides in pertinent part:

> No person shall be . . . deprived of life, liberty, or property, without due process of law . . .

Section 1 of the Fourteenth Amendment to the United States Constitution provides in pertinent part:

> No State shall enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law . . .

STATEMENT OF THE CASE

Toshiba America sought to have the California courts review an arbitral award by applying the standard of review established under the Federal Arbitration Act, 9 U.S.C. §§1, *et seq.* Calling the issue of review "close," the California Superior Court applied the California state standard of review. Toshiba America appealed to the Court of Appeal and sought review under the federal standard of review. The Court of Appeal called state court application of a federal review standard a "slippery" approach to the law, refused to apply the federal standard and applied the California state standard on the ground that the general governing law clause in the parties' contract had chosen California law. (App. B)

The substantive issues to be reviewed on appeal yielded different results under the federal standard for review of an award than under the California state standard applicable to an intrastate arbitration not otherwise subject to the Federal Arbitration Act. Here, the underlying interstate and international transaction (an acquisition involving several hundred million dollars) falls squarely under the Federal Arbitration Act.

The difference between federal and state review, as applicable here, concerns how they deal with public policy issues. Under the California standard, as stated by the Court of Appeal, review may be had only if an award directly contradicts a California statute that establishes an explicit statutory right which the arbitrators reject. Under the federal standard, the court reviews public policy as set forth in both caselaw and statute, including the law of sister states which have the dominant governmental interest at stake. In the underlying case, the public policy issues dealt with the public policies of New York and other states. To state the obvious, no California statute creates New York or any other state's policy. The Court of Appeal therefore constructed a state law review standard under which New York's and other states' public policies would never be considered much less given their full faith and credit.

Specifically, the Court of Appeal held that it would not give public policy review (which under the federal review standard would have been given) to the public policies of affected sister states that forbid indemnifying a person for fraud, punitive damages and a host of intentional misdeeds. It dealt with an arbitrator, "interpreting" a contract covering the sale of a business, which contract contained a clause covering indemnity for only "ordinary course of business" claims resulting from the seller's pre-closing conduct. The seller contended that the buyer had to indemnify the seller for the seller's pre-closing fraud which the seller had allegedly perpetrated on third parties in New York, New Jersey and elsewhere.[1]

That arbitrator held, contrary to New York and other states' laws (which governed the conduct in question), that no public policy exists which limits claims for indemnity by the seller. The arbitrator then manifestly disregarded the law of New York, New Jersey and other states, expanded the contractual language and required that the seller be indemnified by the buyer for actual and punitive damages, even if adjudicated against the seller because of the seller's own fraud, deceit and intentional misconduct.

The arbitrator ruled that Toshiba America had to indemnify Diasonics for all claims arising from Diasonics' pre-closing acts, even claims not yet made, including Diasonics' fraud, all intentional misconduct of any kind whatsoever and punitive damages. (App. D, ¶4 & ¶9). The arbitrator further ruled that

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[1] Diasonics sold complex medical imaging equipment (MRI systems), usually at a price in excess of $1 million each, often to tax shelter promoters, in transactions involving sometimes labyrinthine financial relationships. Various Diasonics customers and others have asserted that Diasonics systematically engaged in a pattern of fraudulent sales practices in order to effect these transactions. While Diasonics (and Toshiba America) have denied the underlying allegations, for purposes of this litigation malicious fraud and intentional conduct must be assumed to have occurred, because the arbitrator ruled that Toshiba America must indemnify even such conduct.

no claim could ever be made that would contravene public policy. (*Id.*)

Toshiba America had shown that as a matter of substantive contract law it owed no such indemnity. Toshiba America further asserted that future claims against Diasonics, and even pending ones (because litigants could amend their claims against Diasonics and could conform their pleading to the proofs), could not be indemnified in the abstract. Rather, the determination of indemnity needed to await the disposition of the claim, at which time the parties could determine the nature of the claim, and then apply the contracts and public policy to such claims. To do otherwise would be irrational.

Toshiba America also argued that, if the contracts were to be construed as asserted by Diasonics, then the contracts would violate public policy. Also, because Diasonics did business nationwide and because the claimants could make (and had made) claims for transactions in multiple states, the public policies of the multiple states affected by the alleged torts concerning indemnity all needed to be taken into account. In general, public policy forbids indemnity for fraud, intentional misconduct and punitive damages. Thus, while the arbitral panel could declare that no such claims could be indemnified, it could not declare that indemnity must be provided for all such claims, for to do so would violate public policy of the States in which the alleged torts have been committed, which have the dominant governmental interest, and which forbid indemnity of fraudulent and intentional wrongdoing as an integral part of their scheme of justice. A blanket declaration of indemnity for all conduct of any kind would thus eviscerate the policies of the affected states.

REASONS FOR GRANTING THE WRIT

I.

Federal Substantive Law Governs Review Of The Arbitration Award

A. Federal Substantive Law Must Apply In Order To Ensure A Consistent, Rational Scheme For Arbitral Review Exists In Federal Arbitration Act Cases.

Federal arbitration law governs the arbitration of disputes affecting interstate commerce. Yet, as a procedural and judicial jurisdictional matter, review of arbitration awards rendered in Federal Arbitration Act arbitrations generally falls to the state courts. The states, of course, must apply substantive federal law to legal proceedings governed by federal law.

In the context of arbitration, this is especially critical, since the validity of an arbitral outcome governed by a federal scheme should not be dependent upon the vagaries of individual states' approaches to arbitration. It thus seems self-evident that federal law controlled the review of this arbitral award. Yet, the Court of Appeal erroneously labeled that concept "slippery" and rejected federal arbitration law in favor of state arbitration law.

It is beyond dispute that the transaction between Toshiba America and Diasonics constitutes interstate commerce and thus, federal substantive arbitration law must control the review of this arbitration award. *See* 9 U.S.C. §§1-16; *Brown v. Rauscher Pierce Refnes, Inc.*, 994 F.2d 775, 778 (11th Cir. 1993); *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 285 (9th Cir. 1988).

This Court has held that when transactions involve interstate commerce, the body of substantive law created by the Federal Arbitration Act preempts any state laws or policies to the contrary even if the agreement to arbitrate contains a choice of law provision. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S.Ct. 1212 (1995). *See Allied-Bruce Terminix Companies, Inc. v. Terminix International Co.*, 115

S.Ct. 834 (1995); *Moses H. Cone Mem. Hosp. v. Mercury Const. Corp.*, 460 U.S. 1, 24 (1983); *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 285 (9th Cir. 1988).

Furthermore, federal substantive law rather than state law governs the review of an arbitration award notwithstanding a choice of law provision or state law to the contrary. *Atlantic Aviation, Inc. v. EBM Group, Inc.*, 11 F.3d 1276, 1280 (5th Cir. 1994); *C.T. Shipping, Ltd. v. DMI (U.S.A) Ltd.*, 774 F. Supp. 146, 148-49 (S.D.N.Y. 1991); *Hilton Constr. Co. v. Martin Mechanical Contractors, Inc.*, 308 S.E.2d 830, 832 (Ga. 1983).

Despite these well settled principles, the California State courts, in a case involving interstate commerce, chose to ignore the federal substantive law created by the Federal Arbitration Act and instead only applied California substantive law. They did so by contorting this Court's ruling that state courts, when handling litigation involving an arbitration, can apply state *procedural* rules in disposing of the case.

In *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989), this Court held simply that state courts, in reviewing arbitral issues, can apply state procedural rules to their review of the legal issues raised. *Id.* at 476. Thus, in *Volt*, this Court held merely that California's courts could apply state rules governing stays in multi-party litigations, some of which involved agreements to arbitrate, not that California substantive law governed the review of arbitration awards rendered in interstate disputes arising from California contracts.

However, the California Court of Appeal in rendering their decision rejected the application of substantive federal law and stated that the distinction between substantive issues and procedural issues is "without significance." (App, B, pg. 4)

The substantive-versus-procedural-law distinction often arises in our federal legal system, whereby procedures differ between federal and state tribunals, both of whom can be called upon to decide federal and state substantive

questions. Plainly, though, the issues raised here concern substance and not procedure. In short, federal substantive arbitration law must govern.

The Court of Appeal, in direct contravention of these well established principles, instead held that California substantive law governed review of the arbitral award (App, B at 4), thus creating a situation where there is direct conflict between the federal decisions and the Court of Appeal's decision. The Court of Appeal erroneously held that the parties' selection of California law as the law that governed the Asset Purchase Agreement meant that state law governs the review of the arbitral award.

B. This Court Granted Certiorari On This Issue For The Current Or Next Term.

This Court on January 5, 1996, granted certiorari in *Doctor's Associates, Inc. v. Casarotto*, 116 S.Ct. 690 (1996) (Docket No. 95-559), a case with a similar question presented as in our situation. In *Doctor's Associates*, this Court will review the Supreme Court of Montana's decision that a Montana arbitration statute is not preempted by the Federal Arbitration Act. As the California courts did here, the Montana Supreme Court erroneously interpreted *Volt* to mean that an area covered by federal substantive arbitration law can be addressed instead by state arbitration law. *Casarotto v. Lombardi*, 901 P.2d 596 (Mont. 1995), *cert. granted,* 116 S.Ct. 690 (1996). As explained above, *Volt* merely held that states can apply its procedural rules to arbitration proceedings. It is obvious that the issue of whether the federal substantive law created by the Federal Arbitration Act preempts state law to the contrary is an important question that this Court must resolve.

Thus, this Court should grant Toshiba America's Petition for a Writ of Certiorari to review this unsettled question presented by Toshiba America. In the alternative, this Court should reserve its decision on this petition pending its determination of *Doctor's Associates*.

II.

A Uniform Federal Standard Is Necessary To Uphold The "Full Faith And Credit" and "Due Process" Due Sister States' Public Policies

Based upon a flawed application of state substantive arbitration law which resulted in the California Court of Appeal applying a standard of review other than the federal standard, the California Court of Appeal also refused to consider the full faith and credit due New York, New Jersey and other states' laws and the requirements of due process.

Federal substantive law requires that an arbitration award be vacated if its enforcement is contrary to public policy. *Brown v. Rauscher Pierce Refnes, Inc.*, 994 F.2d 775, 778 (11th Cir. 1993); *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 285 (9th Cir. 1988); *Delta Air Lines v. Air Line Pilots Ass'n Intern.*,861 F.2d 665, 671 (11th Cir. 1988), *cert. denied*, 493 U.S. 871 (1989); *USPS v. NAIC*, 847 F.2d 775 (11th Cir. 1988). Furthermore, as a matter of federal substantive law, an arbitral award must be set aside when it manifestly disregards the law. *George Day Const. Co. v. United Brotherhood of Teamsters*, 722 F.2d 1471 (9th Cir. 1984).

In general, as a matter of public policy, states hold that indemnity cannot be had for fraud, intentional misconduct or punitive damages. Because the claims against Diasonics arise from transactions spanning the United States, and because the award purports to declare Diasonics' rights with respect to claims not yet even asserted by customers and third-parties, a declaration that every conceivable claim that might be made against Diasonics must be indemnified by Toshiba America of necessity contravenes public policy. Thus, such a declaration is fatally flawed and must be set aside under federal law.

We deal here with a private indemnity contract which, as "interpreted" by the arbitrator, would operate to have one private person relieve another from governmentally imposed punishment for egregious wrongdoing. Just as public policy in most states would forbid a private person from obligating

himself to serve the sentence of another meted out as governmental punishment, vouchsafing private commitments to protect a private person from the yet-to-be-assessed consequences of his wrongdoing and from not-yet-imposed punitive actions intended to deter his future conduct, undermines, indeed eviscerates, the public policy that mandates holding the wrongdoer personally accountable. As regards such subjects, private indemnity contracts, as a matter of public policy itself, cannot even operate as broadly as insurance contracts might since the latter operate in a governmentally regulated environment in which insurance serves governmentally authorized social objectives while the former operate to serve purely private interests.[2]

Indemnifying a tortfeasor for punitive damages, or for its intentional misconduct and its fraud, clearly contravene the laws and public policies of the states in which the alleged misconduct occurred as of the time of the arbitration (New York and New Jersey).

Federal law mandates that California yield to its sister states' public policies which forbid indemnity, in order to impose retribution, punishment and deterrence for fraud and intentional misconduct committed contrary to their governmental interests. The Full Faith and Credit Clause, U.S. CONST. art. IV, §1 and the Due Process Clause, U.S. CONST., amends. V and XIV, require California to duly take into account the policies of New York, New Jersey and other jurisdictions whose laws pertain to the underlying claims against Diasonics. *See, e.g., Hughes v. Fetter*, 341 U.S. 609 (1951); *Home Ins. Co. v. Dick*, 281 U.S. 397 (1930). Both the Full Faith and Credit Clause and the Due Process Clause must be enforced in California. U.S. CONST. art. VI, §2 (the Supremacy Clause). When the public policies of two or more states conflict, the federal constitution requires a state to yield

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[2] Indeed, private indemnity contracts, for example, provide defense only on a claim-by-claim basis, unlike insurance contracts. *Clement v. Consolidated Rail Corp.*,1991 WL 66791 (D.N.J. 1991).

to the greater governmental interest of its sister states, *Hughes*, 341 U.S. at 611-12, requires a state to acknowledge and respect its sister states' rights to declare certain contractual undertakings "invalid," *Dick*, 281 U.S. at 407, and thereby requires a state to yield to its sister states' policies.

Indeed, the underlying cases pending against Diasonics during the arbitration existed principally in other jurisdictions, namely New York and New Jersey. Future claims, those being the essence of the award, likewise would likely not be in California. These states do not allow parties to shift their potential fraud liability to others. *Austro v. Niagara Mohawk Power Corporation*, 487 N.E.2d 267 (N.Y. 1985); *Tryanowski v. Lodi Bd. of Educ.*, 643 A.2d 1057, 1062 (N.J. Super. Ct. 1994.).

As a federal court reaffirmed in *Stratton Group, Ltd. v. Sprayregan*, 466 F. Supp. 1180, 1185 n. 4 (S.D.N.Y. 1979), in a situation involving "common law fraud . . . for reason of public policy an intentional tortfeasor may not escape liability for his conduct by totally shifting it" even if the shift is to "a joint tortfeasor." That has always been and remains the law of common law jurisdictions such as New York. *Epstein v. Haas Securities Corp.*, 731 F. Supp. 1166, 1187 (S.D.N.Y. 1990). Common law jurisdictions have a long, unbroken history which forbids private indemnity for reckless and wilful misstatements. *See generally*, *Globus v. Law Research Service, Inc.*, 418 F.2d 1276, 1288 (2d Cir. 1969), *cert. denied*, 397 U.S. 913 (1970)(invalidating private indemnity agreement). "Generally, anyone who engages in a fraudulent scheme forfeits all right to protection, either at law or in equity." *Kansas City Operating Corp. v. Durwood*, 278 F.2d 354, 357 (8th Cir. 1960). "The principle of public policy is this: *Ex dolo mala non oritur actio*. (Out of fraud no action arises.) . . . . It is upon that ground the Court goes; not for the sake of the defendant, but because they will not lend their aid to such a plaintiff." *Holman v. Johnson*, 98 Eng. Rep. 1120, 1121 (1775) .

New York and New Jersey and certainly common law jurisdictions have strong, fundamental public policies against indemnity for intentional wrongdoing, fraud and punitive damages. Those states consider the obligation that an intentional tortfeasor or perpetrator of fraud bear the prospect of liability for his wrongdoing a necessity in terms of punishment and to effectively deter such conduct. Indemnifying Diasonics in advance of punishment for intentional and fraudulent conduct, which third party claimants against Diasonics assert caused them millions of dollars in damages, contravenes the common law of the jurisdictions where Diasonics committed its wrongs.

CONCLUSION

For all the foregoing reasons, Toshiba America's Petition For A Writ of Certiorari should be granted.

Dated: April 23, 1996

Respectfully submitted,

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IN THE SUPREME COURT OF CALIFORNIA

TOSHIBA AMERICA MEDICAL SYSTEMS INC.,
Appellant

Filed: Jan 30, 1996

v.

OEC MEDICAL SYSTEMS INC., Respondent

Petition for review DENIED.

/s/ LUCAS

Chief Justice

NOT TO BE PUBLISHED IN OFFICIAL REPORTS

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION ONE

TOSHIBA AMERICA MEDICAL SYSTEMS, INC.,

Plaintiff and Appellant,

v.

OEC MEDICAL SYSTEMS, INC.,

Defendant and Respondent.

A067742

(San Francisco County Super. Ct. No. 961597)

A corporation bought a business division of another corporation and agreed to indemnify the seller from certain liabilities relating to the business operations assumed. The parties agreed that any controversy about the purchase contract would be settled by arbitration. A controversy arose when customers sued both corporations for alleged inadequacies of service and goods and stated claims for breach of contract and fraud, among other wrongs, and sought compensatory and punitive damages. Arbitrators decided that the buyer had to fully indemnify the seller on the customer lawsuits and rejected the buyer's argument that indemnification for intentional misconduct, fraud, and punitive damages was beyond the contractual indemnification provision or was precluded by a public policy against shielding intentional wrongdoers. The arbitrators' award in favor of the seller was confirmed by the trial court, over the buyer's effort to have the award vacated, and this appeal followed. We affirm the confirmation order.

STATEMENT OF FACTS

In 1989, appellant Toshiba America Medical Systems, Inc. (Toshiba) purchased substantially all of the business and

assets of the magnetic resonance imaging (MRI) division of respondent Diasonics, Inc. (Diasonics, now known as OEC Medical Systems, Inc.), which manufactured, serviced, and sold MRI medical devices used to examine soft tissue. The purchase agreement with its attachments is a detailed and voluminous document of 171 pages. Under the agreement, Toshiba paid Diasonics $167.5 million and assumed certain liabilities in consideration for receipt of the MRI division as a going concern. Toshiba also agreed to indemnify Diasonics from any damages and costs arising from those liabilities.

In 1992, several MRI customers filed lawsuits against Toshiba and Diasonics in various jurisdictions claiming they received inadequate service and goods that amounted to breach of contract and fraud, among other wrongs. Diasonics tendered the defense of these underlying actions to Toshiba. Toshiba denied an obligation to defend or indemnify Diasonics, at least to the extent that the underlying actions involved intentional misconduct or fraud claims, or sought punitive damages.

In September 1992, Diasonics filed a petition with the American Arbitration Association (AAA) to determine the scope of Toshiba's indemnity obligations. The 1989 purchase agreement provided that its terms would be governed by California law and that any controversy relating to the agreement would be settled by arbitration in accordance with AAA rules and California law. The parties agreed to a three arbitrator panel; Toshiba and Diasonics each selected an arbitrator and the third, neutral arbitrator was mutually selected to chair the panel. The arbitrators were empowered to determine the manner of conducting the arbitration.

The parties submitted their dispute to the panel in the spring of 1993 by the presentation of documentary evidence, legal memoranda, and oral argument. Diasonics states that five volumes of documents and fourteen briefs were submitted. The neutral arbitrator distributed to the other panel members a draft decision in Diasonics favor to which the Toshiba-appointed arbitrator, Joseph Stallings, objected. Stallings

disagreed with the decision's conclusion, and also objected to the lack of substantive deliberations before its circulation. The arbitrators then conferred, but Stallings found the discussion futile because he felt a final decision had already been made.

A majority of the arbitrators (the neutral arbitrator and the Diasonics-appointed arbitrator) issued an interim decision in April 1993, from which Stallings dissented. This decision was to be the first interim decision, as the arbitrators requested further party submissions on other issues which were resolved in a second interim decision issued in December 1993. Stallings also dissented from that December decision favorable to Diasonics, after having participated in the second round of proceedings which included a panel conference. Stallings resigned soon after issuance of the second interim decision, upon protests that the neutral arbitrator did not permit meaningful discussions in the arbitral process.

Toshiba appointed a replacement arbitrator who reiterated Stallings' claim that the arbitration had proceeded without meaningful discussions and the replacement proposed beginning anew, "with deliberations to begin as if nothing had heretofore transpired." The other arbitrators apparently rejected this proposal, and issued their award incorporating the two interim decisions in March 1994. Toshiba filed a petition in superior court to vacate the arbitrators' award and Diasonics filed a cross-petition to confirm the award. The arbitrators' award was confirmed on October 7, 1994, and this appeal followed.

DISCUSSION

California Law Governs our Review of the Arbitrators' Award

Toshiba's challenge to the arbitrators' award begins with the preliminary argument that federal law, not California law, governs our review of the award. Toshiba notes that the Federal Arbitration Act (FAA) (9 U.S.C. § 1 et seq.) applies to arbitration provisions in contracts involving interstate commerce and preempts any conflicting state law. (*Allied-Bruce*

Terminix Companies v. Dobson (1995) __ U.S. __ [115 S.Ct. 834, 839-843].) However, the parties here agreed that both the terms of the contract and the arbitration of any controversy under the contract would be governed by California law. The FAA does not prevent contracting parties from agreeing to abide by state rules of arbitration. (*Volt Info. Sciences v. Leland Stanford Jr. U.* (1989) 489 U.S. 468, 479.) In recognition of this freedom of contract, California courts have respected the parties' recognition of this freedom of contract, California courts have respected the parties' choice of state law in the arbitration of contracts involving interstate commerce. (*Engalla v. Permanente Medical Group, Inc.* (1995) 37 Cal.App.4th 497, 519-521; *Pacific Gas & Electric Co. v. Superior Court* (1993) 15 Cal.App.4th 576, 587, fn. 3.)

Toshiba attempts to limit the rule of *Volt Info. Sciences,* claiming that the case permits parties to choose state procedural rules of arbitration but that federal law always governs substantive issues in the arbitration of contracts involving interstate commerce, regardless of the parties' choice of law. Toshiba's proposed distinction between arbitration procedure and arbitration substance is slippery to grasp. But assuming such a distinction can be maintained, it is a distinction without significance. Whether termed procedural rules or substantive issues, the contours of the arbitration process should be within the crafting power of the parties who have chosen arbitration to resolve their conflicts. Arbitration "is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit." (*Volt Info. Sciences v. Leland Stanford Jr. U., supra,* 489 U.S. at pp. 478-479.) Certainly, contracting parties may limit the issues that they will arbitrate. *(Ibid.)* We see no reason why contracting parties may not also specify the law to be applied to the issues that they will arbitrate, at least so long as the chosen law does not undermine the FAA's policy ensuring the enforceability of arbitration agreements. Here, the parties' choice of California law to govern the arbitration of controversies arising under the purchase agreement does not offend any federal policy. The parties' choice must be respected.

Review of Arbitration Awards is Limited

Under California law, the review of a private arbitration award is narrow and deferential. "[A]n arbitrator's decision is not generally reviewable for errors of fact or law, whether or not such error appears on the face of the award and causes substantial injustice to the parties." *(Moncharsh v. Heily & Blase* (1992) 3 Cal.4th 1, 6.) A court's power to correct or vacate an arbitration award is limited to those statutory grounds specified in Code of Civil Procedure sections 1286.2 and 1286.6 which generally authorize the court's involvement to protect parties from an abuse of the arbitral process, such as where arbitrators have "exceeded their powers." *(Moncharsh, supra,* at pp. 26-28; Code Civ. Proc., § 1286.2, subd. (d).) Judicial intervention may also be appropriate if the arbitration award enforces a contract which is illegal in its entirety or, in exceptional circumstances, where a portion of the contract is clearly illegal. But "[a]bsent a clear expression of illegality or public policy undermining [the] strong presumption in favor of private arbitration, an arbitral award should ordinarily stand immune from judicial scrutiny." *(Moncharsh, supra,* at p. 32.)

The Arbitrators Did Not Exceed Their Powers

Toshiba contends that the arbitration award must be vacated because the arbitrators "exceeded their powers" in interpreting the purchase agreement. (Code Civ. Proc., § 1286.2, subd. (d).) Toshiba's chief complaint arises from the arbitrators' interpretation of the assumption of liabilities provisions. In the purchase contract, Toshiba agreed to assume certain liabilities on the closing date pursuant to an assumption agreement of specified terms. The later executed assumption agreement precisely reflects those terms and provides, in relevant part, as follows:

> "Purchaser [Toshiba] hereby assumes, and agrees to pay and discharge in due course, all debts, liabilities, contracts, obligations and agreements of, and claims against, Seller [Diasonics] relating to the [MRI] Division and the Subsidiaries (whether or not expressly identified on the Closing Pro Forma

> Balance Sheet), whether matured or unmatured, liquidated or unliquidated, fixed or contingent, or known or unknown, whether arising out of occurrences prior to the date hereof, or arising at or after the date hereof in the ordinary course of business ...."

The assumed liabilities were further defined to include several enumerated categories of liabilities and also defined to exclude other categories, none of which encompass the particular liabilities Diasonics sought to have indemnified here. It is the general assumption of liabilities provision which the arbitrators interpreted.

The arbitrators concluded, in their first interim decision, that Toshiba's broad assumption of liabilities plainly included the fraud claims in the underlying actions for which Diasonics sought indemnity. Toshiba argued in arbitration, and argues on appeal, that indemnity is limited to liabilities arising in the "ordinary course of business" and that fraud is not such a liability. The arbitrators rejected that interpretation, finding that the qualification "in the ordinary course of business" applies only to occurrences "arising at or after the date hereof," and the arbitrators understood that date to be August 23, 1989, the date of the purchase contract.

In essence, the arbitrators decided that Toshiba agreed to broadly indemnify Diasonics for liabilities arising before the purchase date, but limited its indemnification for liabilities arising between the purchase and closing dates to those liabilities related to the "ordinary course of business" to guard against a detrimental change in Diasonics' conduct of the business at a time when it had a signed purchase agreement in hand and was just maintaining the business until Toshiba took over the operations. Since the arbitrators decided that the "ordinary course of business" limitation had only a narrow temporal application irrelevant to the underlying actions, the arbitrators found it unnecessary to decide whether the fraud claims arose in the "ordinary course of business."

Toshiba disputes the arbitrators contractual interpretation, arguing that the "ordinary course of business" qualification

relates to all liabilities. In other words, Toshiba argues that an error of law occurred in the arbitrators' interpretation of the parties' contract. "[A]rbitrators do not exceed their powers merely by erroneously deciding a contested issue of law or fact." *(Advanced Micro Devices, Inc. v. Intel Corp.* (1994) 9 Cal.4th 362, 366, citing *Moncharsh v. Heily & Blase, supra,* 3 Cal.4th at p. 28.) However, it remains an open question as to when, if ever, an erroneous interpretation of a contract constitutes an action in excess of arbitral power. Division Five of this district has endorsed a standard predating *Moncharsh* and declared that " 'a decision exceeds the arbitrator's powers only if it is so utterly irrational that it amounts to an arbitrary remaking of the contract between the parties.' " *(Blue Cross of California v. Jones* (1993) 19 Cal.App.4th 220, 228; accord, *Pacific Gas & Electric Co. v. Superior Court, supra,* 15 Cal.App.4th at pp. 592-593.) But Division Three of this district has questioned the continuing vitality of the "completely irrational" standard. *(Hall v. Superior Court* (1993) 18 Cal.App.4th 427, 434-435.)

Our Supreme Court is cognizant of the controversy but has not yet had occasion to determine "whether an arbitrator's interpretation of a contract is subject to review for 'irrationality' or 'arbitrariness.' " *(Advanced Micro Devices, Inc. v. Intel Corp., supra,* 9 Cal.4th at p. 377, fn. 10.) The court has, however, delineated a standard for determining whether an arbitrator has exceeded his or her powers in awarding relief for a breach of contract: the remedy "must bear some rational relationship to the contract and the breach." *(Id.* at p. 381.) "The award will be upheld so long as it was even arguably based on the contract; it may be vacated only if the reviewing court is *compelled* to infer the award was based on an extrinsic source." *(Ibid.)* In fashioning this standard, the court was aided by federal cases applying the "essence" test which holds that an arbitrator's award is legitimate so long as it draws its essence from the contract. *(Id.* at pp. 377-378.)

The "completely irrational" standard has its origin in the "essence" test, and both seem animated by the recognition

that an arbitrator's powers derive from the arbitration agreement and are exceeded if he or she operates wholly outside its framework. *(Advanced Micro Devices, Inc. v. Intel Corp., supra,* at pp. 375, 377, fn. 11.) The close relation between the "completely irrational" standard and the "essence" test which informed the court's formulation of its rule for the review of an arbitrator's breach of contract remedy lends support to Toshiba's argument that the "completely irrational" standard has not lost all value after *Moncharsh.* The extent of that value, of course, is unclear, and it is far from certain that the "completely irrational" standard is a worthy guide for assessing whether an arbitrator's contract interpretation is in excess of his or her powers. However, even if we accept this standard, the award here remains inviolate.

" '[A] decision exceeds the arbitrator's powers only if it is so utterly irrational that it amounts to an arbitrary remaking of the contract between the parties.' [Citations.] 'The mere fact that a different construction could have been accorded the provisions concerned and a different conclusion reached does not mean that the arbitrators so misread those provisions as to empower a court to set aside the award.' " (*Blue Cross of California v. Jones, supra,* 19 Cal.App.4th at p. 228.) "[A]rbitrators do not exceed their power by erroneously interpreting a contract. A valid claim that arbitrators have exceeded their power exists only where the arbitrators' interpretation or application of a contract is completely outside its scope." *(Id.* at p. 229.) Here, the arbitrators interpreted the reach of the qualifying clause "ordinary course of business" and found that it did not modify the entire indemnification provision defining liabilities, but only the last clause relating to liabilities arising after the date of the purchase agreement. Toshiba's effort to paint this workaday resolution of contract terms as an irrational "rewriting" of the contract is futile.[1] "Where, as here, the arbitrator's reading and

---

[1] Similarly, Toshiba's claim that the arbitrators misinterpreted its assumption of liability for a bank guaranty does not establish a "completely irrational" decision.

application of the contract is clearly within the range of ambiguity, i.e., within the ordinary bounds of semantic permissibility, there can be no tenable claim that the contract has been arbitrarily remade. "*(Pacific Gas & Electric Co. v. Superior Court, supra,* 15 Cal.App.4th at p. 594.)

The Arbitration Award Does Not Offend Public Policy

Toshiba argues that the arbitration award must be vacated because it contravenes public policy which forbids indemnity for fraud, intentional misconduct and punitive damages. The arbitrators themselves considered public policy concerns. They concluded that nothing forbid the indemnification of fraud and intentional misconduct occurring before the date of the purchase contract, noting that Civil Code section 2774 provides that; "[a]n agreement to indemnify a person against an act already done, is valid, even though the act was known to be wrongful, unless it was a felony." The arbitrators found "no showing by Toshiba that any of the underlying actions involved conduct by Diasonics that constituted a felony." The arbitrators also considered the question of whether punitive damages could be contractually indemnified. The arbitrators' decision, rendered in the affirmative, was based on factual determinations concerning the arm's length negotiations by these sophisticated parties and legal conclusions about the nature and goals of punitive damages and corporate accountability.

Toshiba bears a heavy burden in claiming that the arbitrators' decision violates public policy. Our Supreme Court has grudgingly acknowledged that there may be some limited and exceptional circumstances justifying judicial review of an arbitrator's decision when a party claims illegality affects only a portion of the underlying contract. Such cases would include those in which granting finality to an arbitrator's decision would be inconsistent with the protection of a party's statutory rights. [Citation.] [¶] Without an explicit legislative expression of public policy, however, courts should be

reluctant to invalidate an arbitrator's award on this ground." *(Moncharsh v. Heily & Blase, supra,* 3 Cal.4th at p. 32.)

We are properly reluctant. This situation is not the rare case where "according finality to the arbitrator's decision would be incompatible with the protection of a statutory right." *(Moncharsh v. Heily & Blase, supra* 3 Cal.4th at p. 33.) Nor do we discern a clear expression of public policy contradicting the arbitrators' decision. No California law directly addresses the question of whether a corporate successor may contractually indemnify its predecessor for punitive damages relating to the predecessor's past conduct of the business operations it assumes. Nor is it clear that Civil Code section 2774's proscription against indemnifying felonies applies -- as Toshiba claims -- to any "felonious conduct," including large-scale fraud, even if no criminal charges are ever filed. Toshiba has simply failed to establish that the arbitrators' decision harms the public interest.

There Was No Arbitrator Misconduct

An arbitration award will be vacated where "[t]he rights of the party were substantially prejudiced by misconduct of a neutral arbitrator." (Code Civ. Proc., § 1286.2, subd. (c).) Toshiba claims the neutral arbitrator, Peter Anderson, engaged in misconduct by refusing to confer and deliberate with Stallings, the Toshiba appointed arbitrator, and by having communications with Diasonics' counsel and the Diasonics appointed arbitrator in Stallings' absence. Toshiba has grossly mischaracterized the arbitration proceedings.

The parties chose a three arbitrator panel. Each party appointed one arbitrator and the third panel member was mutually selected as a neutral arbitrator to chair the proceedings. All arbitrators were experienced attorneys and they were expressly empowered to determine the manner of conducting the arbitration. Stallings made no objection to the arbitration procedures until Anderson issued the draft of his first interim decision in favor of Diasonics. It was at that time that Stallings complained that Anderson did not permit meaningful deliberations among all arbitrators before reaching his

conclusions. Anderson explained that he issued a draft decision, rather than convene the panel for discussions, because the parties' positions had already been exhaustively presented in hearings before the panel and there was no need to have the party-appointed arbitrators reiterate the same oral arguments. The procedure of submitting a draft decision to the party-appointed arbitrators avoided repetition of argumentation while permitting them an opportunity to participate in the decision-making process by pointing out any arguments that had been "overlooked or misunderstood." Anderson had told the party-appointed arbitrators that he was considering proceeding in this manner and was surprised that Stallings later decried the procedure. In deference to Stallings' concerns, a different procedure was adopted in the second round of proceedings and a panel conference was held before issuance of a draft decision. Our review of the record convinces us that the neutral arbitrator conducted the arbitration proceedings fairly and honestly.

Toshiba's claim that Anderson engaged in "inexcusable ex parte communication" with Diasonics' counsel and Diasonics' appointed arbitrator is equally meritless. The communications were minor and wholly innocent. Anderson's communication with Diasonics' counsel occurred when counsel called Anderson's office to inquire about the anticipated release of the first interim decision and Anderson answered the telephone. Anderson told Diasonics' counsel that the decision's release would be delayed a few days and the conversation ended. Anderson disclosed that communication to the AAA and it found no impropriety. The other challenged ex parte communication was a telephone call to Anderson from the Diasonics appointed arbitrator to ask if the terms of the recently released draft interim decision could be revealed to Diasonics. During neither of these communications was the merits of the case discussed or even mentioned. Toshiba's claim of arbitrator misconduct is absurd, and appears to be no more than an attempt to manufacture grounds to vacate an unfavorable arbitration award at the expense of an arbitrator's reputation.

DISPOSITION

The order confirming the arbitration award is affirmed.

_____
Strankman, P.J.

We concur:

_____
Stein, J.

_____
Dossee, J.

APPENDIX C

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Formerly known as DIASONICS, INC.

SUPERIOR COURT OF CALIFORNIA
COUNTY OF SAN FRANCISCO

TOSHIBA AMERICA MEDICAL SYSTEMS, INC., a California Corporation., Petitioner, vs. OEC MEDICAL SYSTEMS, INC., a Delaware corporation, formerly known as Diasonics, Inc., Respondent.	CASE No. 961597 JUDGMENT BY COURT UNDER C.C.P. §1287.4
OEC MEDICAL SYSTEMS, INC., a Delaware Corporation, formerly known as Diasonics, Inc., Cross-Petitioner, vs. TOSHIBA AMERICA MEDICAL SYSTEMS, INC., a California Corporation, Cross-Respondent.	

The award of arbitrators Peter Anderson and William O. Dillingham, dated March 3, 1994, in the Matter of the Arbitration Between Diasonics, Inc. and Toshiba America Medical Systems, Inc., American Arbitration Association No. 74 199 01113 92, having been confirmed by order of this Court, dated October 6, 1994.

IT IS ORDERED, ADJUDGED AND DECREED that judgment is hereby entered in favor of respondent and cross-petitioner OEC Medical Systems, Inc., formerly Diasonics, Inc., pursuant to this Court's Order filed October 7, 1994.

Dated: February 23, 1995

/s/ WILLIAM CAHILL

William Cahill
Judge of the Superior Court

APPROVED AS TO FORM.

Dated: February 17, 1995

Ford Marrin Esposito Witmeyer & Gleser

/s/ John J. Witmeyer III/CMR

John J. Witmeyer III
Attorneys for Petitioner and Cross-Respondent Toshiba America Medical Systems, Inc.

APPENDIX D

AMERICAN ARBITRATION ASSOCIATION

COMMERCIAL ARBITRATION TRIBUNAL
AWARD OF ARBITRATORS

In the Matter of Arbitration between

Re: 74 199 01113 92
Diasonics, Inc.
and
Toshiba America Medical Systems, Inc.

WE, THE UNDERSIGNED ARBITRATORS, having been designated in accordance with the Arbitration Agreement entered into by the above-named Parties, and dated August 23, 1989 and having been duly sworn and having duly heard the proofs and allegations of the Parties, AWARD, as follows:

Pursuant to the determination of a majority of the Panel as set forth in the Initial Interim Decision, dated April 2, 1993 ("INITIAL INTERIM DECISION") and in the Second Interim Decision, dated December 6, 1993 ("SECOND INTERIM DECISION"), which are incorporated by reference, the following AWARD is hereby entered:

1. TOSHIBA AMERICA MEDICAL SYSTEMS, INC. ("TOSHIBA") shall fully indemnify and reimburse DIASONICS, INC. and its affiliates, subsidiaries, officers, directors, and employees (collectively, "DIASONICS") for all costs and expenses (including all attorneys fees) incurred by DIASONICS as of the date of this AWARD in each of the following actions.

(a) MEDICAL DIAGNOSTIC IMAGING CENTER ET AL V. DIASONICS, ET AL., NO. BC054409, now pending in the Superior Court of the State of California for the County of Los Angeles;

(b) MOBILE MR VENTURE, LTD. V. TOSHIBA AMERICA MEDICAL SYSTEMS ET AL., NO. 373320, now pending before the American Arbitration Association;

(c) MEDICAL IMAGING CENTER OF SOUTHERN CALIFORNIA, LTD. V. TOSHIBA AMERICAN MEDICAL SYSTEMS, INC. ET AL., NO. BC047496, now pending in the Superior Court for the State of California for the County of Los Angeles;

(d) FEDERAL DEPOSIT INSURANCE CORPORATION V. LENOX HILL RADIOLOGY ASSOCIATES ET AL., NO. 92 CIV 3374, Now pending in the United States District Court for the Southern District of New York;

(e) LENOX HILL LEASING ASSOCIATES ET AL. V. TOSHIBA AMERICA MEDICAL SYSTEMS, INCORPORATED ET AL., now pending in the Supreme Court of the State of New York for the County of New York; and

(f) TME ORANGE, INC. V. TOSHIBA AMERICA MEDICAL SYSTEMS, INC. ET AL., NO. L-16799-92, asserted as a cross-claim in the Superior Court of New Jersey County of Essex.

Each of the actions set forth in (a) - (f) above is hereinafter referred to as the "PENDING ACTIONS".

2. TOSHIBA's obligation to fully indemnify DIASONICS in the PENDING ACTIONS as discussed in Paragraph 1 of this AWARD is not subject to the "ordinary course of business" language contained in Section 1.3(c) of the parties' Asset Purchase Agreement, dated August 23, 1989 ("ASSET PURCHASE AGREEMENT") and Paragraph 1 of the Assumption Agreement, dated November 21, 1989 ("ASSUMPTION AGREEMENT"). The language "in the ordinary course" qualifies only those assumed liabilities arising between August 23 and November 21, 1989 and, as so limited, need not be construed in order to resolve the PENDING ACTIONS.

3. The obligation of TOSHIBA to fully indemnify and reimburse DIASONICS in the PENDING ACTIONS as discussed in Paragraph 1 of this AWARD and/or in any Future Action(s) (as defined in Paragraph 8 of this AWARD) is not subject to the 1% threshold set forth in Section 9.2(c) of the ASSET PURCHASE AGREEMENT, as Section 9.2(c) does not govern TOSHIBA's assumption of liabilities as discussed in this AWARD or apply to Section 9.2(b)(3) of the ASSET PURCHASE AGREEMENT, the provision under which DIASONICS is entitled to indemnify.

4. Excluding only those liabilities specifically enumerated and excluded in Section 1.3(c) of the ASSET PURCHASE AGREEMENT and Schedule 1.3 thereto, TOSHIBA assumed all debts, liabilities, contracts, obligations and agreements of, and claims against DIASONICS relating to Diasonics' Magnetic Resonance Imaging ("MRI") Division. After considering all of the evidence submitted by the parties, a majority of the Panel concluded that there should be no departure from the plain meaning of TOSHIBA's broad assumption of liabilities as set forth in Section 1.3(c) of the ASSET PURCHASE AGREEMENT and Paragraph 1 of the ASSUMPTION AGREEMENT. Accordingly, TOSHIBA's assumption of such liabilities extends to, but is not limited to, liability resulting from all claims or causes of action, both legal and equitable, against DIASONICS (including, but not limited to, claims arising under principles of contract and/or tort law), including any liability of DIASONICS for breach of contract and/or the commission of any tort or fraud, whether intentional or negligent, resulting from, arising from, or relating to DIASONICS' MRI Division. Liability for such acts, having not been specifically excluded or excepted from the ASSET PURCHASE AGREEMENT's and ASSUMPTION AGREEMENT's broad liability provisions, was assumed by TOSHIBA. No public policy precludes indemnification for such wrongful conduct occurring prior to the date on which the assumption is made or indemnification is given. *See* Cal.Civ. Code Sec. 2774.

5. TOSHIBA's argument that the language of the ASSET PURCHASE AGREEMENT and ASSUMPTION AGREEMENT should be construed against DIASONICS is rejected by a majority of the Panel. The principle of contract interpretation upon which TOSHIBA relies is applicable only when the parties do not have actual bargaining power and the words of the contract are ambiguous. *Neal v. State Farm Ins. Co.*, 188 Cal. App. 2d 690, 695; 1 Witkin, Summary of California Law (9th Ed.), Contracts, Section 698, and cases cited. However, the principle is inapplicable when, as here, the parties have equivalent bargaining power and there is no ambiguity.

6. TOSHIBA assumed liability for Diasonics Guaranty and Diasonics Shortfall Agreement upon which the Federal Deposit Insurance Corporation's claims against DIASONICS and TOSHIBA are based in *Federal Deposit Insurance Corporation v. Lenox Hill Radiology Associates Et AL.*, No. 92 Civ. 3374, referenced in Paragraph 1(d) above. The failure of Citytrust to consent to DIASONICS' assignment to TOSHIBA of the Diasonics Guaranty and Diasonics Shortfall Agreement does not affect this result. DIASONICS' liability under the Diasonics Guaranty and Diasonics Shortfall Agreement is a liability falling within the broad assumption provisions of Section 1.3(c) of the ASSET PURCHASE AGREEMENT, and, as such, is a liability assumed by TOSHIBA. Moreover, neither the Diasonics Guaranty nor the Diasonics Shortfall Agreement contains any prohibition against assignment without the consent of Citytrust or its successors and assigns. For reasons discussed in the Initial Interim Decision, TOSHIBA's argument that DIASONICS' failure to obtain Citytrust's consent to its assignment of the Diasonics Guaranty and Diasonics Shortfall Agreement constituted a breach or default of such Guaranty and Shortfall Agreement thereby ineffectuating or invalidating TOSHIBA's assumption of liability under either agreement is rejected by a majority of the Panel.

7. TOSHIBA shall fully indemnify DIASONCIS for all liability and/or damages (including, but not limited to, all future attorneys fees, costs, and expenses) incurred by

DIASONICS subsequent to the date of this AWARD in each of the PENDING ACTIONS. For the reasons discussed in the INITIAL INTERIM DECISION and Paragraph 2 and 3 of this AWARD, TOSHIBA's obligation to fully indemnify DIASONICS in the PENDING ACTIONS is subject to neither the "ordinary course of business" language contained in Section 1.3(c) of the ASSET PURCHASE AGREEMENT and Paragraph 1 of the ASSUMPTION AGREEMENT nor the 1% threshold set forth in Section 9.2(c) of the ASSET PURCHASE AGREEMENT. TOSHIBA's obligation to indemnify DIASONICS in the PENDING ACTIONS and/or the Future Action(s) (as defined in Paragraph 8 of this AWARD) includes, but is not limited to, the obligation to indemnify DIASONICS for liability for fraud and/or intentional or negligent misrepresentation.

8. In the event that any person or entity files, or has filed, any action other than the PENDING ACTIONS seeking to hold DIASONICS liable for damages, monetary or otherwise, resulting from, arising from, or relating to DIASONICS' MRI division (the "Future Action(s)"), TOSHIBA shall indemnify DIASONICS for all liability and/or damages (including all attorneys fees, costs, and expenses) incurred by DIASONICS in the Future Action(s) except to the extent that such liability was specifically not assumed by TOSHIBA under Section 1.3(c) of the ASSET PURCHASE AGREEMENT and Schedule 1.3 thereto. As discussed in Paragraph 7 of this AWARD, TOSHIBA's obligation to indemnify DIASONICS for the Future Action(s) includes, but is not limited to, all liability and/or damages incurred by DIASONICS in connections with, or arising out of, any claim or allegation that DIASONICS and/or any of its employees made any intentional or negligent misrepresentation or otherwise committed any fraud.

9. TOSHIBA acquired a division of DIASONICS and any award of punitive damages would relate to that division. Under these circumstances, California public policy does not prevent enforcement of TOSHIBA's obligation to indemnify DIASONICS with respect to such damages. Accodingly, in

the event that an award of punitive or exemplary damages is entered against DIASONICS in the PENDING ACTIONS or the Future Action(s), TOSHIBA shall indemnify DIASONICS for any such damages.

10. The ASSET PURCHASE AGREEMENT provided that the terms thereof were governed by the laws of the State of California. No basis has been shown for the application of the law of any other state.

11. TOSHIBA has withdrawn it counterclaim.

12. The Administrative Fees of the American Arbitration Association totaling SIX THOUSAND SIX HUNDRED AND NO DOLLARS ($6,600) shall be borne by the parties equally.

13. The compensation and expenses of the Neutral Arbitrator totaling FIFTY THREE THOUSAND FIVE HUNDRED FIFTY FIVE DOLLARS AND EIGHTY EITHT CENTS ($53,555.88) shall be borne by the parties equally.

This AWARD, in conjunction with INITIAL INTERIM DECISION and the SECOND INTERIM DECISION, is in full settlement of all claims submitted to this arbitration.

DATED: March 3, 1994 /s/ Peter Anderson

Peter Anderson, Esq.

DATED: March 3, 1994 /s/ William O. Dillingham

William O. Dillingham, Esq.

DATED:

Robert A. Miller, Esq.

Supreme Court, U.S.
FILED
MAY 29 1996
CLERK

No. 95-1756

In The

Supreme Court of the United States

October Term, 1995

TOSHIBA AMERICA MEDICAL SYSTEMS, INC.,

Petitioner,

v.

OEC MEDICAL SYSTEMS, INC.,

Respondent.

On Petition For A Writ Of Certiorari To The Court Of Appeal Of California, First Appellate District

BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI

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QUESTION PRESENTED

Did the California Court of Appeal properly confirm an arbitration award under California law where two California residents expressly agreed that their arbitration would be governed by California law and where the California standards of reviewing an arbitration award are not in conflict with either federal law or policy?

RULE 29.6 STATEMENT

Respondent OEC Medical Systems, Inc. has no parent company. Respondent's only non-wholly owned subsidiary is Barwig Medizinische Systeme GmBH.

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BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Respondent, OEC Medical Systems, Inc., formerly known as Diasonics, Inc. ("Diasonics"), respectfully opposes the petition of Toshiba America Medical Systems, Inc. ("Toshiba") for a writ of certiorari.

OPINIONS BELOW

The arbitration panel that presided over this matter issued two interim decisions in addition to the final arbitration award reprinted as Appendix D to Toshiba's petition. The panel's First Interim Decision is reprinted as Appendix A to this opposition brief at page A1.[1] The panel's Second Interim Decision is reprinted as Appendix B, at page A20.

INTRODUCTION AND SUMMARY OF ARGUMENT

Toshiba seeks to overturn an unpublished decision of the California Court of Appeal confirming an arbitration award against it and in favor of Diasonics. This case presents no questions worthy of this Court's attention.

Because the parties' arbitration agreement contained an explicit California choice-of-law provision, the California court properly reviewed and confirmed the award

[1] References to the appendices bound with this opposition brief are styled ("A___"). References to the appendices bound with Toshiba's petition are styled ("Toshiba App. ___").

under California law. The court was correct in concluding that federal law did not pre-empt state law since the California law governing the review of arbitration awards does not conflict with the Federal Arbitration Act ("FAA") or any other federal law or policy. *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University,* 489 U.S. 468 (1989).

The Full Faith and Credit and Due Process Clauses of the United States Constitution have no application to this case because Toshiba selected California law to apply to its dispute with Diasonics. Because the agreement at issue was negotiated (and consummated) in California between two California residents and related to the sale of a California business, California has an extensive connection to the parties and their agreement and a substantial interest in applying its law to the parties' dispute. By contrast, Toshiba failed to demonstrate that any other jurisdiction has any governmental interest rivaling that of California. The California court therefore did not err in concluding that it was under no obligation to yield to the laws of other states. *Nevada v. Hall,* 440 U.S. 410 (1979); *Sun Oil Co. v. Wortman,* 486 U.S. 717 (1988).

STATEMENT OF CASE

A. Factual Background

Toshiba acquired Diasonics' magnetic resonance imaging ("MRI") business seven years ago for $167.5 million. Under the parties' 51-page Asset Purchase Agreement, dated August 23, 1989 (the "Agreement"), Toshiba acquired the assets and assumed the liabilities of

the purchased business division. More specifically, Toshiba assumed the following:

> [T]he debts, liabilities, contracts, obligations and agreements of, and claims against, the Seller relating to the Division and the Subsidiaries (whether or not expressly identified on the Closing Pro Forma Balance Sheet), whether matured or unmatured, liquidated or unliquidated, fixed or contingent, or known or unknown, whether arising out of occurrences prior to the date hereof, or arising after the date hereof in the ordinary course of business.

See Interim Decision at A3. Toshiba also agreed to indemnify Diasonics for any liability or damages "arising from" the assumed liabilities. *Id.*

In addition to agreeing that the contract as a whole would be governed by California law, Toshiba and Diasonics expressly agreed that any controversy or disagreement arising out of the Agreement would be settled by binding arbitration in accordance with the "rules and regulations of the American Arbitration Association ("AAA") and, to the extent not inconsistent therewith . . . , the laws of the State of California." (quoting Agreement at § 10.12(b)).

Approximately three years after Toshiba acquired the MRI business, a handful of former Diasonics customers filed state court civil actions against Toshiba and Diasonics in California, New Jersey, and New York. Each plaintiff alleged that Diasonics sales personnel made representations regarding the future maintenance and support of the equipment purchased by plaintiffs and that those representations were not honored after Toshiba's

acquisition of the MRI division. Plaintiffs asserted causes of action against both Diasonics and Toshiba for breach of contract, breach of warranty, and intentional and negligent misrepresentation. Toshiba denied any obligation to indemnify Diasonics for liability incurred in connection with the claims for intentional misconduct.

B. The Arbitration

On September 11, 1992, Diasonics filed a petition with the American Arbitration Association to enforce Toshiba's indemnity obligations. After extensive briefing and a lengthy hearing, a majority of the arbitrators issued an Interim Decision on April 2, 1993 in Diasonics' favor. *See* A1-19. The arbitration panel found that under the "broad sweeping language" and "plain words" of the Agreement, Toshiba assumed liability for intentional tort claims relating to the MRI division. *Id.* at A4. The panel also rejected Toshiba's argument that Toshiba's indemnity agreement contravened California public policy, finding that the California Civil Code expressly sanctions retrospective indemnification for intentional acts that occurred prior to the grant of indemnity.[2] *Id.* at A7. Because Diasonics' alleged conduct in the underlying actions occurred before the Agreement, the panel concluded that

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[2] Section 2774 of the California Civil Code provides as follows:

> INDEMNITY FOR A PAST WRONGFUL ACT VALID. An agreement to indemnify a person against an act already done, is valid, even though the act was known to be wrongful, unless it was a felony.

Toshiba's indemnification obligations under the Agreement should be fully enforced. In a subsequent decision, the panel also concluded that California law does not preclude a successor corporation, such as Toshiba, from indemnifying its predecessor for punitive damages. *See* A35-36.

Notwithstanding having argued throughout the arbitration that California law was the only law relevant to its indemnity obligations, Toshiba sought reconsideration of the panel's initial decision on the ground that the arbitrators incorrectly applied California law to the parties' dispute, rather than the laws of other states in which the underlying actions were pending. The panel rejected Toshiba's argument and enforced the parties' choice of law agreement. The panel's decision was based upon California's strong public policy in favor of enforcing contractual choice of law provisions, particularly where, as in this case, the parties to the underlying contract are California residents who negotiated their agreement in California. *See* A36-46. The panel also concluded that Toshiba failed to demonstrate that the result in the arbitration would have been different under the law of New Jersey or New York – the jurisdictions in which two of the underlying actions were pending. On March 3, 1994, a majority of the arbitrators issued a final award in Diasonics' favor. *See* Toshiba App. D.

C. The State Court Proceedings

On October 7, 1994, the Superior Court of California, County of San Francisco, denied Toshiba's petition to

vacate the arbitration award and entered an Order confirming the award. That Order was affirmed on October 25, 1995 by the California Court of Appeal, First Appellate District, in an unpublished decision. On January 30, 1996, the Supreme Court of California denied Toshiba's petition for review of the Court of Appeal's decision.

REASONS FOR DENYING THE WRIT

I. The California Court of Appeal's Decision Enforcing the Parties' Arbitration Agreement is Fully Consistent with the Federal Arbitration Act.

A. This Court Has Already Ruled Against Toshiba on the Very Issue Raised by Toshiba's Petition.

This Court's decision in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989), is dispositive of Toshiba's argument that the FAA pre-empts state law any time an arbitration agreement involves interstate commerce.[3] In *Volt*, this Court held that the FAA does not pre-empt a parties' choice-of-law provision selecting state law, provided that the state law does not "undermine the goals and policies of the FAA." *Id.* at 478. Here, as in *Volt*, the parties' arbitration agreement contained a California choice-of-law provision. Here, as in *Volt*, the petitioner argues that because the parties' contract involved interstate commerce, the FAA pre-empted the California arbitration

[3] As noted above, Toshiba did not seek to apply the law of any jurisdiction other than California until *after* it had suffered an adverse result in the arbitration.

statute. This Court held that "the California [arbitration] statute is not pre-empted by the Federal Arbitration Act . . . in a case where the parties have agreed that their arbitration agreement will be governed by the law of California." *Id.* at 470.

Toshiba's argument that *Volt's* holding is restricted to state procedural rather than substantive law is unavailing. Although *Volt* involved a state procedural rule, this Court's ruling was not premised upon – and did not even discuss – the procedural/substantive distinction upon which Toshiba's petition is based. To the contrary, this Court emphasized without distinction that arbitration "is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements *as they see fit.*" *Id.* at 479 (emphasis added). This Court also explained that a party's state choice-of-law provision should be respected because "[t]he FAA contains no express pre-emptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration." *Id.* at 477 (*citing Bernhardt v. Polygraphic Co.*, 350 U.S. 198 (1956)).

Toshiba has cited no authority in support of its narrow interpretation of *Volt*. To the contrary, several courts have applied *Volt's* holding to state choice-of-law provisions that involve substantive as well as procedural law. *E.g., Ekstrom v. Value Health, Inc.*, 68 F.3d 1391 (D.C. Cir. 1995) (the FAA does not pre-empt Connecticut's substantive law regarding confirmation of an arbitration award); *St. Luke's Hosp. v. SMS Computer Systems, Inc.*, 785 F. Supp. 1243, 1246-47 (E.D. Mich.1991) (the FAA does not pre-empt the application of state law to court's review of arbitration award), *aff'd in part, reversed in part on other*

grounds mem., 955 F.2d 1067 (6th Cir. 1993); *Flight Systems v. Paul A. Laurence Co.*, 715 F. Supp. 1125, 1127-28 (D.D.C. 1989) (in light of the "recent *Volt* decision, the Court finds that it should apply Virginia law . . . and not the FAA in analyzing [a] motion to vacate").

Toshiba's argument that "federal substantive law must control the review of the arbitration award" whenever the underlying contract involves interstate commerce is not supported by the cases upon which Toshiba relies. Neither *Brown v. Rauscher Pierce Refsnes, Inc.*, 994 F.2d 775, 778 (11th Cir. 1993), nor *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 285 (9th Cir. 1988), involved a contractual choice-of-law provision which selected state law; in the absence of such a contractual provision, the FAA therefore supplied the rule of decision.

Toshiba also misplaces reliance on *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S. Ct. 1212 (1995). In *Mastrobuono*, this Court again emphasized that the FAA favors the enforcement of arbitration clauses according to their terms. *Id.* at 1216. The issue in *Mastrobuono* was one of reconciling the parties' choice of New York law, which bars arbitrators from awarding punitive damages, with a conflicting contractual provision mandating the use of an NASD rule that permits such an award. This Court ruled that, as a matter of contract interpretation, the express reference to NASD rules manifested an intent not to incorporate New York's limitation on the arbitrators' authority to award punitive damages. *Id.* at 1219. By

contrast, there is no ambiguity in the instant case regarding the parties' intention to apply California law to any dispute arising under the Agreement.[4]

In sum, this Court has consistently resolved arbitration disputes "to ensure the enforceability, *according to their terms*, of private agreements to arbitrate." *Volt*, 489 U.S. at 476 (emphasis added). Indeed, it was precisely to encourage arbitration that the FAA was enacted. *Id.*; *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24-25 (1991). The California Court of Appeal properly enforced the parties' agreement to arbitrate under California law. The Federal Arbitration Act does not pre-empt that result.

B. Toshiba Has Failed to Demonstrate that the California Standards for Reviewing an Arbitration Award Are In Conflict with the Federal Standards.

Toshiba has failed to demonstrate that the California standard of review of arbitral awards conflicts with the federal standard or that application of the federal standard would lead to a different result in this case.

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[4] Toshiba's reliance on *Atlantic Aviation, Inc. v. EBM Group, Inc.*, 11 F.3d 1276 (5th Cir. 1994), is also misplaced. There, the court found that a state law denying appellate jurisdiction over court orders directing an arbitral rehearing conflicted with FAA provisions allowing appeal of such orders. Here, by contrast, Toshiba has not shown any conflict with federal law or policy. *See* § I.B., *infra*. Moreover, *Atlantic Aviation* is highly questionable in light of its failure to consider this Court's decision in *Volt* and its reliance instead on decisions pre-dating *Volt*.

Under both California and federal law, judicial review of arbitration awards is extremely deferential and limited. *E.g., Pack Concrete, Inc. v. Cunningham*, 866 F.2d 283, 285-86 (9th Cir. 1989); *Advanced Micro Devices, Inc. v. Intel Corp.*, 9 Cal. 4th 362, 373, 36 Cal. Rptr. 2d 581 (1994). Indeed, the statutory bases for vacating an arbitration award under the FAA and the California Code of Civil Procedure are virtually identical.[5] *See United States v.*

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[5] The FAA (9 U.S.C. § 10) permits an award to be vacated in these instances:

(1) Where the award was produced by corruption, fraud, or undue means.

(2) Where there was evident partiality or corruption in the arbitrators, or either of them.

(3) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing . . . or refusing to hear evidence pertinent and material to the controversy; or any other misbehavior by which the rights of any party have been prejudiced.

(4) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made. . . .

California Code of Civil Procedure § 1286.2 permits an award to be vacated in these instances:

(a) The award was procured by corruption, fraud or other undue means.

(b) There was corruption in any of the arbitrators.

(c) The rights of the party were substantially prejudiced by misconduct of a neutral arbitrator.

(d) The arbitrators exceeded their powers and the award cannot be corrected without affecting the merits of the decision upon the controversy submitted.

Ets-Hokin Corp., 284 F. Supp. 471, 476 (N.D. Cal. 1966) ("California law is the same as federal law insofar as grounds for vacating or correcting the award are concerned."), *aff'd*, 397 F.2d 935 (9th Cir. 1968).

Rather than argue a conflict between the California and federal statutory grounds for vacating an arbitration award, Toshiba argues that federal decisional law provides a non-statutory basis for vacating an award – *i.e.*, that the award is contrary to public policy. The cases cited by Toshiba do not support application of a public policy exception to the enforcement of the arbitration award in this case. *See Brown v. Rauscher Pierce Refsnes, Inc.*, 994 F.2d 775, 782 (11th Cir. 1993) (declining to vacate award as against public policy where plaintiff's argument was "no more than a complaint that the [arbitrators] failed to interpret the law correctly"); *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282 (9th Cir. 1988) (compelling arbitration under the FAA without discussing public policy exception to enforcement of awards); *George Day Construction Co. v. United Brotherhood of Carpenters and Joiners of America*, 722 F.2d 1471, 1477-79 (9th Cir. 1984) (award

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(e) The rights of the party were substantially prejudiced by the refusal of the arbitrators to postpone the hearing upon sufficient cause being shown therefor or by the refusal of the arbitrators to hear evidence material to the controversy or by other conduct of the arbitrators contrary to the provisions of this title.

(f) An arbitrator making the award was subject to disqualification upon grounds specified in subdivision (e) of Section 1282, but failed upon receipt of timely demand to disqualify himself or herself as required by those provisions. . . .

that certain contract provisions survived the expiration of a collective bargaining agreement did not manifestly disregard the law or violate any federal labor policy); *United States Postal Service v. Nat'l Ass'n of Letter Carriers*, 847 F.2d 775 (11th Cir. 1988) (affirming vacation of award on ground that award was arbitrary and capricious where award required reinstatement of postal employee convicted of stealing mail).[6]

Moreover, even accepting the existence of a public policy exception to the enforcement of arbitration awards under the FAA, California law is consistent with federal law in this regard. *See Moncharsh v. Heily & Blase*, 3 Cal. 4th 1, 32 , 10 Cal. Rptr. 2d 183 (1992) (courts should enforce arbitration awards "[a]bsent a clear expression of illegality or public policy undermining [the] strong presumption in favor of private arbitration"). The California public policy exception is not limited to cases where an award violates California statutory rights, but more broadly applies whenever "granting finality to an arbitrator's decision would be inconsistent with the protection of a party's statutory rights." *Id.* at 32. Thus, rather than

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[6] Toshiba cites only one case, *Delta Air Lines v. Air Line Pilots Ass'n Int'l*, 861 F.2d 665 (11th Cir. 1988), *cert. denied*, 493 U.S. 871 (1989), in which an arbitration award was set aside as contrary to public policy. In that case, the court affirmed the vacation of the portion of an arbitration award finding that an airline did not have just cause for firing a pilot who flew while intoxicated. The court observed that the facts presented a "*rare example* of an award the enforcement of which would violate *clearly established* public policy which condemns the operation of passenger airliners by pilots who are under the influence of alcohol." *Id.* at 671 (emphasis added).

"undermine the goals and policies of the FAA," California law is perfectly consistent with those policies.

Both the arbitrators and the California Court of Appeal fully considered and rejected Toshiba's argument that public policy prevented enforcement of the award in this case. The result would be no different under the federal standard of review, which is the same as the California standard. There is therefore no basis to review the Court of Appeal's decision.

C. In *Doctor's Associates, Inc. v. Casarotto*, 116 S. Ct. 690 (1996), This Court Did Not Grant Certiorari On Any Issue Presented in this Case.

Contrary to Toshiba's argument, this Court has not recently granted certiorari on any issue relevant to this case. In *Doctor's Associates, Inc. v. Casarotto*, 116 S. Ct. 690 (1996), *reversed*, 1996 WL 262287 (May 20, 1996), this Court considered a Montana statute voiding all arbitration agreements that fail to include the notice of arbitration in underlined, capital letters on the first page of any contract in which an arbitration agreement appears. This statute, enforced by the Montana Supreme Court, conflicted with the FAA's policy favoring the enforcement of arbitration agreements. On May 20, 1996, this Court reversed the Supreme Court of Montana, holding that the FAA pre-empts the Montana statute because "Montana's law places arbitration agreements in a class apart from any contract, and singularly limits their validity." *Doctor's Associates, Inc. v. Casarotto*, No. 95-559, 1996 WL 262287, at *5 (May 20, 1996).

In contrast to the Montana statute at issue in *Doctor's Associates*, the California rules governing the vacatur of arbitral awards strongly favor the enforcement of arbitration agreements and are nearly identical to the federal rules. *Doctor's Associates* provides no reason for this Court to grant Toshiba's petition for a writ of certiorari.

II. The Court of Appeal's Decision Enforcing A California Choice-of-Law Provision in an Agreement Between Two California Residents Relating to the Sale of A California Business Does Not Violate the Full Faith and Credit or Due Process Clauses.

The Full Faith and Credit clause has no application to this case. Applied primarily in the conflict of laws context, it places constitutional limits on a forum's selection of its own law to govern disputes potentially governed by the laws of different sovereigns. *See, e.g., Allstate Ins. Co. v. Hague*, 449 U.S. 302 (1980); *Bradford Electric Light Co. v. Clapper*, 286 U.S. 145 (1932).

The Full Faith and Credit clause has no application where the parties have contractually chosen to be governed by the laws of a particular state. This Court and the lower federal courts have consistently enforced such choice-of-law clauses. *See, e.g., National Equipment Rental, Ltd. v. Szukhent*, 375 U.S. 311 (1964); *General Signal Corp. v. MCI Telecommunications Corp.*, 66 F.3d 1500 (9th Cir. 1995), *cert. denied*, 116 S. Ct. 1017 (1996); *Price v. Pierce*, 823 F.2d 1114 (7th Cir. 1987), *cert. denied*, 485 U.S. 960 (1988); *S.A. Empresa De Viacao Aerea Rio Grandense v. Boeing Co.*, 641 F.2d 746 (9th Cir. 1981).

Moreover, this Court has long held that the Full Faith and Credit clause "does not require a State to apply another State's law in violation of its own legitimate public policy," *Nevada v. Hall*, 440 U.S. 410 (1979), and "does not compel 'a state to substitute the statutes of other states for its own statutes dealing with a subject matter concerning which it is competent to legislate.' " *Sun Oil Co. v. Wortman*, 486 U.S. 717, 722 (1988) (quoting, *Pacific Employers Ins. Co. v. Industrial Accident Comm'n*, 306 U.S. 493, 501 (1939)). California has already enacted laws governing the enforceability of indemnity agreements, a matter on which "it is competent to legislate." *See* Cal. Civ. Code § 2772 *et seq.* Having established its public policy regarding indemnity, California need not defer to other states' policies in this dispute between California residents regarding a contract for the sale of California assets.[7]

Nor does application of California law in the present case violate Toshiba's due process rights. Toshiba selected California law to apply to this dispute, a choice enforced by the arbitrators and the California Court of Appeal. Toshiba utterly fails to explain how due process is implicated by enforcement of its own selection of California law.[8]

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[7] *Hughes v. Fetter*, 341 U.S 609 (1951), does not support Toshiba's argument. In *Hughes*, this Court held unconstitutional a statute that denied the parties, many of whom were Wisconsin residents, access to Wisconsin's courts merely because the injury occurred in another state.

[8] *Home Ins. Co. v. Dick*, 281 U.S. 397 (1930), the only case cited by Toshiba decided under the due process clause, does not support Toshiba's argument. In *Home*, the Court held

Toshiba nonetheless advances a governmental interest approach in an attempt to void its own selection of California law. Toshiba Petition at 10-11. While a governmental interest analysis might be appropriate where the parties did not contractually agree on the governing law, it has no place where California residents have chosen California law to govern their dispute. California, the forum state, applies its own law to determine the outcome of any potential conflict of law. *Day & Zimmerman, Inc. v. Challoner*, 423 U.S. 3 (1975). In that context, California requires enforcement of the parties' choice of law without ever reaching the governmental interest approach suggested by Toshiba. *Nedlloyd Lines B.V. v. Superior Court*, 3 Cal. 4th 459, 471, 11 Cal. Rptr. 2d 330 (1992).

Indeed, even if there were no choice of law provision in the Agreement, the governmental interest analysis advocated by Toshiba would still result in a constitutionally appropriate application of California law. *Allstate Ins. Co. v. Hague*, 449 U.S. 302, 312-13 (1981) ("[F]or a State's substantive law to be selected in a constitutionally permissible manner, that State must have a significant contact or significant aggregation of contacts, creating state interests, such that choice of its law is neither arbitrary nor fundamentally unfair.").

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unconstitutional the application of Texas law to a dispute regarding an insurance clause that lacked a choice-of-law provision because "nothing in any way relating to the policy sued on, or to the contract of reinsurance, was ever done or required to be done in Texas." 281 U.S. at 408.

Toshiba is incorporated and headquartered in California. Diasonics was also headquartered in California. The MRI division and virtually all of the assets acquired by Toshiba were located in California. A substantial portion of the contract negotiations (including the contract closing) occurred in California. The only issue in this case – indemnity between California residents – is expressly addressed by California legislation (Cal. Civ. Code §§ 2773-74). Likewise, California has a strong interest in enforcing its citizens' choice of law and the finality of arbitrations to which its citizens agreed. *Moncharsh*, 3 Cal. 4th at 9-10; *Nedlloyd Lines B.V. v. Superior Court*, 3 Cal. 4th 459, 471, 11 Cal. Rptr. 2d 330 (1992).

Toshiba suggests that these interests should yield to the interests of New York and New Jersey. Neither New York nor New Jersey have an interest in the indemnity obligations between California residents. These states' paramount interest is in ensuring that their citizens' right to compensation, if it is established, is not impaired by the application of California law. *In re Air Crash Diaster Near Chicago, Illinois on May 25, 1979*, 644 F.2d 594, 613 (7th Cir.), *cert. denied*, 454 U.S. 878 (1981). Because the indemnity provision enforced by California addresses only the rights of Diasonics and Toshiba *inter se*, without diminishment of their obligations to third parties, New York or New Jersey's interests in this regard are unaffected. Moreover, to the extent New York and New Jersey have any interest in deterrence, that interest has already been addressed by the California legislature. *Compare* Cal. Civ. Code § 2774 (allowing indemnity for past wrongful conduct) *with* Cal. Civ. Code § 2773 (prohibiting indemnity for future wrongful conduct). Thus,

neither New York nor New Jersey have any unaddressed governmental interest sufficient to displace California law. Thus, the Court of Appeal properly applied California law to the parties' agreement.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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May 29, 1996

APPENDIX A

AMERICAN ARBITRATION ASSOCIATION

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Diasonics, Inc.

-and-

Toshiba America Medical Systems, Inc.

INTERIM DECISION

I. INTRODUCTION

At the prehearing conference herein on January 21, 1993, the Panel ruled that the issues raised by Claimant DIASONICS, INC. ("Diasonics") would be tried in an initial round of hearings in early March and the issues raised by the counterclaim of Respondent TOSHIBA AMERICA MEDICAL SYSTEMS ("Toshiba") would be tried in a second round of hearings in the latter part of May. The parties thereafter stipulated that the Panel should render its decision with respect to the Diasonics claim on the basis of the documentary evidence and the written and oral argument of counsel.

The issues were fully briefed by the parties. A hearing was held on March 9, 1993, the documents were received in evidence, and the Panel heard the argument of counsel. Permission was granted to submit additional authority on an issue that arose at the hearing and to provide written counterparts of certain handwritten exhibits. The parties advised the Panel that they had no

further evidence to submit respecting the claim of Diasonics.

The parties advised the Panel that the "written decision" provision in Section 10.12(b) of the Asset Purchase Agreement would be satisfied by a brief decision by the Panel that ruled on the issues tendered by the parties. This interim decision has therefore been prepared.

It is important to note that this interim decision does not constitute an award as that term is used in Rule 41 and in Code of Civil Procedure Section 1283.4. Rather, this interim decision is issued to guide the parties pending the final award that will issue following the second round of hearings and the closing of the proceedings pursuant to Rule 35. However, the rulings set forth in this interim decision will be incorporated in the declaratory relief provisions in the final award herein.

All arguments presented by the parties in their thorough presentations herein have been considered, whether or not specifically discussed.

II. DETERMINATION OF THE ISSUES

The conclusions of a majority of the Panel with respect to the principal issues herein are discussed in turn below. The first subject to be discussed will be whether claims against Diasonics that include allegations of fraudulent misrepresentations in connection with sales of products of the Division constitute liabilities that were assumed by Toshiba pursuant to the Asset Purchase Agreement.

A. Section 1.3 of the Asset Purchase Agreement

Section 1.3 of the Asset Purchase Agreement is the principal basis of Diasonic's claim. It provided in material part that Toshiba would:

> "Assume on the Closing Date, pursuant to an Assumption Agreement substantially in the form of Exhibit 1.3 hereto (the "Assumption Agreement"), and agree to pay and discharge in due course, the debts, liabilities, contracts, obligations and agreements of, and claims against, the Seller relating to the Division and the Subsidiaries (whether or not expressly identified on the Closing Pro Forma Balance Sheet), whether matured or unmatured, liquidated or unliquidated, fixed or contingent, or known or unknown, whether arising out of occurrences prior to the date hereof, or arising at or after the date hereof in the ordinary course of business (such assumed debts, liabilities, contracts, obligations, agreements and claims, the "Liabilities"), including (i) any liabilities associated with the British Technology Group patent portfolio (the "BTC Patent Liabilities"), and (ii) liabilities and obligations arising from any claims under warranty obligations related to, or imposed by law in respect of, any products sold, or arising from the performance or non-performance of any contract or agreement assumed by the Purchaser pursuant to this Section 1.3(c) or any other transaction occurring in connection with the business of the Division, whether existing on the Closing Date or arising thereafter. Notwithstanding the foregoing, Liabilities shall not include those liabilities relating to the Division and the Subsidiaries that are expressly set forth on Schedule 1.3 hereto, liabilities with

> respect to indebtedness for borrowed money (except as set forth on the Closing Pro Forma Balance Sheet or in Schedules 3.3.1 or 3.9) and liabilities for Taxes that are obligations of the Seller under Section 5.4 (collectively, the "Non-Assumed Liabilities"). Except for the Liabilities, the Purchaser shall not be responsible for, and shall not assume or in way become liable with respect to, any debts, liabilities or obligations of the Seller".

Section 1.3 did not expressly provide that Toshiba would pay claims based on fraud committed by Diasonics prior to the Closing Date. Nor did it expressly provide that any liabilities based on fraud committed by Diasonics were excluded from Toshiba's assumption obligation. There was no reference to fraud claims in Schedule 1.3.

The parties submitted a number of arguments respecting the correct interpretation of Section 1.3 under these circumstances. The conclusions of a majority of the Panel will be set forth in turn.

Plain meaning of the words: The plain words of Section 1.3 support Diasonics. In broad sweeping language, Toshiba assumed all liabilities that were not expressly excluded. Fraud claims were encompassed by the broad language. They were not excluded either by Schedule 1.3 or by the exceptions set forth in Section 1.3. Hence, while liabilities of Diasonics for fraud were not expressly identified in Schedule 1.3, such liabilities were assumed (*SCM Corp. v. Berkeley, Inc.*, 73 Cal. App. 3d 49,

57-58 (1977)), unless some other language in the documentation of the transaction or some principle of contract interpretation requires a different conclusion.

Ordinary course of business qualification: After the broad terminology, Section 1.3 continued with these words: "whether arising out of occurrences prior to the date hereof, or arising at or after the date hereof in the ordinary course of business".

A majority of the Panel concluded that the plain meaning of these words is that the qualification "in the ordinary course of business" is applicable only to occurrences "arising at or after the date hereof". Even a comma may have profound legal significance. *State Farm Mut. Auto. Ins. Co. v. Flynt*, 17 Cal. App. 3d 538, 547 (1971) ("Semantically and grammatically the limiting clause did not modify the entire insuring agreement, but only the clause which immediately preceded it").

Hence, it is unnecessary to decide whether or not fraud claims arising out of earlier occurrences would or would not be "in the ordinary course of business".

Drafting history: The Panel received in evidence documents pertaining to the negotiations between the parties prior to the execution of the Asset Purchase Agreement. As might be expected, it was apparent that throughout the negotiations the goal of Diasonics was to induce Toshiba to assume the maximum amount of the liabilities of the Division, while the goal of Toshiba was to avoid an open-ended assumption of liabilities. The evidence after being considered in its totality did not persuade a majority of the Panel that there should be any departure from the plain meaning of Section 1.3.

Toshiba vigorously contended that since the critical words of Section 1.3 were drafted by counsel for Diasonics, they should be construed against Diasonics. This principle of contract interpretation is applicable when the parties do not have equal bargaining power and the words of the contract are ambiguous. *Neal v. State Farm Ins. Co.*, 188 Cal. App. 2d 690, 695 (1961); 1 Witkin, Summary of California Law [9th Ed.], Contracts, Section 698, and cases cited. However, the principle is inapplicable when, as here, the agreement is not ambiguous. *Neal* at 690. Moreover, here the parties had equivalent bargaining power and both parties were advised by astute and experienced counsel during the negotiations.

Failure to discuss fraud during negotiations: There was no indication in the evidence that the parties gave any consideration during the negotiations to the possibility that after the closing lawsuits could be brought against Diasonics alleging that it had committed fraud in the course of dealing with customers of the Division prior to the closing. With the advantage of 20-20 hindsight, one can see that it would have been desirable to have addressed the subject. But in the context of what was known to the participants at the time, any criticism of skilled counsel or the principals would be most inappropriate.

Toshiba argued that if anyone had thought of the possibility of fraud during the negotiations, fraud would have been excluded from the definition of Liabilities in Section 1.3. Obviously, Toshiba would have taken that negotiating stance. However, it may only be conjectured whether Diasonics would have yielded on this issue or

whether Diasonics in the give and take of the negotiations would have obtained other changes to the Asset Purchase Agreement in favor of Diasonics. The Panel must interpret and apply the agreement in the form that it was executed by the parties.

Public policy considerations: Section 1.3 would not be enforceable if Toshiba had agreed to indemnify Diasonics for fraudulent acts committed after the effective date of the agreement. Civil Code Section 2773; Corbin on Contracts, Section 1471, and cases cited.

However, Section 2774 of the Civil Code provides:

> "An agreement to indemnify a person against an act already done, is valid, even thought [sic] the act was known to be wrongful, unless it was a felony".

There was no showing by Toshiba that any of the underlying actions involved conduct by Diasonics that constituted a felony. Hence, Section 2774 permits application here of the plain words of Section 1.3.

A further issue remains. It is possible that in one or more of the underlying actions a trier of fact will ultimately award punitive damages in favor of the plaintiff.

Insofar as an award were to be for compensatory damages pursuant to Civil Code Sections 3333 and 3343, Section 2774 would not bar application of Section 1.3. However, if punitive damages were to be assessed against Diasonics, a trier of fact would necessarily have determined that an award should be made "for the sake of example and by way of punishing defendant". Civil Code Section 3294(b).

The parties did not sufficiently address in their briefs the issue whether Section 2774 would or would not validate an agreement to indemnify another party against an award of punitive damages. As noted below, the Panel requests further briefs on this issue.

Lack of any specific reference to "fraud": There remains for consideration the question whether the broad sweeping language of Section 1.3 may be deemed to cover fraud claims in the absence of a specific reference to fraud therein.

The parties cited a number of cases on this subject to the Panel. A majority of the Panel concluded that decisions that did not involve the acquisition of a line of business or that involved indemnification for future conduct were not particularly helpful. Additionally, one of the cases most heavily relied upon by Toshiba, *Smoketree-Lake Murray, Ltd. v. Mills Concrete Construction Co.*, 234 Cal. App. 3d 1724 (1991), involved a construction contract subject to the special rules set forth in Section 2782 of the Civil Code. 234 Cal. App. 3d at 1742. The general observations in the *Smoketree* opinion on page 1741 were made in that context.

Two decisions discussed by the parties involved acquisitions of a line of business, parties with substantially equivalent bargaining power, and indemnification for past conduct: *SCM Corp. v. Berkel, Inc.*, 73 Cal. App. 3d 49 (1977) and *Schwartz v. Pillsbury, Inc.*, 969 F. 2d 840 (9th Cir. 1992).

In *SCM*, an indemnification agreement with language similar to Section 1.3 of the Asset Purchase Agreement was held sufficient to require the purchasing corporation

to indemnify the seller for a negligence claim relating to a product that had been sold long before the date of the acquisition. The Court held that in the context of an agreement to acquire an entire business, it was not "necessary to look for unusually clear, express language in order to find a provision transferring tort liability". 33 Cal. App. 3d at 58. The Court's rationale for this conclusion is persuasive. 33 Cal. App. 3d at 58-59. However, the underlying action in *SCM* did not involve a fraud claim.

Schwartz also involved the sale of a line of business. The buyer agreed to assume "agreements and contracts entered into in the ordinary course of business". 969 F.2d at 845. The Ninth Circuit held that the buyer did not thereby assume liability for fraudulent misrepresentations made by the seller to a franchisee. *Id.* The *SCM* case was not discussed in the opinion. *Schwartz* is distinguishable from the present dispute because the agreement contained an "in the ordinary course of business" limitation. That limitation is not present here under the plain wording of Section 1.3 of the Asset Purchase Agreement.

Moreover, while any decision of the Ninth Circuit is entitled to respectful consideration, Federal decisions are not controlling on issues of state law. 9 Witkin, California Procedure [3rd Ed.], Appeal, Section 781, and cases cited.

Here, the fraud claims in the underlying actions are based on allegations that Diasonics made misrepresentations respecting the quality of its products and personnel, and that Diasonics concealed an intention not to maintain or upgrade the products. The plaintiffs in the underlying actions asserted in other claims that Diasonics breached contractual commitments respecting its products. The

common thread in all the underlying actions is that the plaintiffs had entered into business relationships with Diasonics respecting its product line and were sorely aggrieved by the subsequent failure of Diasonics and Toshiba to conform to the plaintiffs' expectations.

A majority of the Panel concluded that under these circumstances the *SCM* rationale is applicable and Toshiba assumed liability under Section 1.3, notwithstanding the lack of an express reference to fraud. Toshiba, represented by competent counsel, agreed in sweeping language to assume the liabilities of the Division. It agreed to take the sour with the sweet. There is no basis to allow it to escape from its undertaking.

Conclusion respecting Section 1.3: A majority of the Panel concluded that the liabilities assumed by Toshiba pursuant to Section 1.3 of the Asset Purchase Agreement included liabilities of Diasonics arising from tort claims by purchasers of products of the Division alleging that Diasonics made fraudulent misrepresentations in connection with the sale of the products.

B. Conflict with Assumption Agreement

Section 1.3 of the Asset Purchase Agreement, quoted in full above, provided that it would be implemented by the execution of an Assumption Agreement substantiating the form of Exhibit 1.3 thereto. The date was left blank in Exhibit 1.3.

The Asset Purchase Agreement was dated August 23, 1989. The Assumption Agreement was dated November 21, 1989. Critical wording in both documents read,

"whether arising out of occurrences prior to the date hereof, or arising at or after the date hereof in the ordinary course of business". The question thus arises whether "the date hereof" in the Assumption Agreement refers to August 23, 1989 or November 21, 1989.

A strange result would be reached if the November 21, 1989 date were deemed applicable. From the closing date forward, Diasonics was out of the picture and Toshiba assumed control of and was fully responsible for the operation of the Division. Hence, the qualifying words, "or arising at or after the date hereof in the ordinary course of business" would be wholly redundant. If, on the other hand, the August 23, 1989 date were deemed applicable, the qualifying words would be applicable to matters occurring between August 23, 1989 and November 21, 1989. It does make sense for the parties to make a distinction between liabilities arising before the date of the Asset Purchase Agreement, and liabilities arising after that date and before the closing date. Otherwise, the parties may have concluded, Diasonics, once it had a signed agreement in hand for the purchase of the assets of the Division, might change its manner of operation of the Division to the detriment of the buyer.

A majority of the Panel concluded that "the date hereof" refers to August 23, 1989. The Asset Purchase Agreement is an elaborately crafted document. It is not probable that the parties intended to make such a substantive change thereto when they executed the Assumption Agreement in order to implement their undertakings in the Asset Purchase Agreement.

C. Section 9.2(b)(3)

Section 9.2(b)(3) of the Asset Purchase Agreement provided:

> "The Purchaser shall indemnify and hold harmless the Seller and its Affiliates from and against all Damages arising from:
>
> . . . .
>
> "(3) the Liabilities as of the Closing and the conduct of the business associated with the Assets after the closing".

A majority of the Panel concluded that the underlying tort actions constituted "Liabilities" as that term is defined in the agreement. It is therefore unnecessary to rule upon Diasonics' further contention that Toshiba became obligated to indemnify Diasonics because the underlying tort claims arose from "the conduct of the business" by Toshiba after the closing.

D. The Lenox Hill Action

The underlying action in the *Lenox Hill* case, Exhibit 1036, raises an issue that is not present in the other underlying actions.

The FDIC as receiver for a failed financial institution, Citytrust, alleged that Diasonics guaranteed payment of a loan made by Citytrust and that the loan was in default. The FDIC asserted that Diasonics was liable as the original guarantor of the loan and that Toshiba was liable by virtue of the Asset Purchase Agreement and also by reason of two assignment agreements that were executed by Diasonics and Toshiba.

It is undisputed that the guaranty related to the Division that was purchased by Toshiba. The obligation is clearly a liability under the broad language of Section 1.3 of the Asset Purchase Agreement.

That is not the end of the matter. Toshiba contends that it did not assume the liability in view of paragraph 3 of the Assumption Agreement. It provided:

> "Notwithstanding any provision herein to the contrary, this Assumption Agreement shall not constitute an agreement or an attempted agreement to transfer or assign any agreement, contract, lease, license, permit or other instrument or any claim or right or any benefit arising thereunder or resulting therefrom if an attempted transfer or assignment thereof, without the consent of any other party thereto, would constitute a breach thereof or in any other way adversely affect the rights of Purchaser thereunder. Seller shall use its best efforts to assist Purchaser to obtain consents to the assignment of the foregoing to Purchaser in accordance with the conditions more fully set forth in Section 2.4 of the Purchase Agreement".

Toshiba argued that by virtue of Section 3 it did not assume any liabilities wherein the consent of the other party to an agreement was required and not obtained. However, Section 3 does not provide that any failure to obtain a consent to an assignment will relieve Toshiba from its obligation to Diasonics under the Asset Purchase Agreement. Further, the guaranty agreement is in evidence as Exhibit 97. It does not contain any prohibition

against an unconsented assignment. The FDIC in its lawsuit maintains, for obvious reasons, that the assignment was valid. Exhibit 1036, paragraphs 71-74.

Toshiba further contended that the sale of the assets of the Division pursuant to the Asset Purchase Agreement was an act of default under Section 8(b) of the guaranty. The FDIC did not take this position in its complaint and a majority of the Panel does not accept Toshiba's interpretation of Section 8(b). In any event, the obligation of Toshiba under Section 1.3 of the Asset Purchase Agreement would be unaffected.

A majority of the Panel therefore concluded that paragraph 3 of the Assumption Agreement does not allow Toshiba to avoid its obligation with respect to the Lenox Hill case.

E. Issues Relating to Implementation of the Decision

A number of issues were raised by the parties respecting implementation of the Panel's decision interpreting the Asset Purchase Agreement.

Timeliness of Any Decision Respecting Indemnity: Toshiba contends that a decision whether it should indemnify Diasonics in a particular underlying action would be premature, inasmuch as litigants may amend their claims and a litigant's ultimate claims and the outcome thereof will not be known until the litigation ends. The Panel agrees. *CNA Casualty of California v. Seaboard Surety Co.*, 176 Cal. App. 3d 598, 605 (1986).

Declaratory relief is an appropriate remedy to determine the extent of an indemnity obligation. The Panel has the authority to grant declaratory relief in the award under Section 10.12(b) of the Asset Purchase Agreement, Rule 43, and Section 1283.4 of the Code of Civil Procedure.

With the assistance of able counsel, the award herein will be in a form that should eliminate most if not all future disputes respecting indemnity issues, notwithstanding the wide range of possible outcomes in the underlying cases.

Duty to Defend: Unless "a contrary intention appears", an indemnitor may be required by the indemnitee "to defend actions or proceedings brought against the latter [the indemnitee] in respect of the matters embraced by the indemnity". Civil Code Section 2778(4).

Here, as Toshiba correctly pointed out, a "contrary intention" appears from Section 9.3 of the Asset Purchase Agreement. Detailed provisions are set forth therein respecting the mechanics of defending an underlying action in an indemnity situation. Toshiba has the option to, but is not required to, take over the defense of an action. Accordingly, Toshiba may, if it wishes to do so, elect to require Diasonics to defend itself in a pending action, subject, of course, to the obligation to reimburse Diasonics for litigation costs discussed immediately below.

Apportionment of Cost of Defense: During the pendency of the dispute, Toshiba advised Diasonics that it would defend both itself and Diasonics with respect to

breach of contract and warranty claims relating to customer product performance and service. Toshiba further advised Diasonics that it would defend the fraud claims, non-indemnifiable in the view of Toshiba, only if Diasonics would pay a prorated share of the defense costs. Diasonics rejected this proposal. Consequently, in at least some of the underlying actions, Toshiba and Diasonics are defended by separate counsel.

Toshiba took this posture at the risk that it would have to reimburse Diasonics for its litigation costs if the Panel were not to agree with Toshiba's interpretation of Section 1.3. That eventuality has now occurred. In light of the Panel's ruling, Diasonics' litigation costs are "damages" as defined in the Asset Purchase Agreement and they are reimbursable by Toshiba pursuant to Section 9.2(b)(3).

The 1% Threshold Issue: The Asset Purchase Agreement provided in Section 9.2(c)(1):

> "Notwithstanding anything to the contrary in this Agreement, (1) neither Seller nor Purchaser shall be required to indemnify and hold harmless the other or the other's Affiliates until and to the extent that aggregate Damages owed to the other and its Affiliates with respect to all claims asserted under this Section 9.2 equal or exceed 1% of the Purchase Price; provided, however, that no dollar threshold shall apply with respect to claims that (x) relate to the representations and warranties contained in Sections 3.20 and 4.4, or (y) arise pursuant to Sections 9.2(a)(3), 9.2(a)(4), 9.2(b)(3) or 9.2(b)(4). . . . "

The term "Damages" is defined in Section 1.1 as:

> " . . . any loss, liability to third parties, however defined or characterized, damages, cost or expense (including reasonable costs of investigation, defense and prosecution of litigation and attorney's fees) incurred by such person."

It is understood from the parties' briefs that 1% of the purchase price is approximately $1.9 million and that Diasonics to date has not paid this amount.

Toshiba argued that the reference to Section 9.2(b)(3) in the last sentence of Section 9.2(c) means that the 1% threshold does not apply to "Liabilities" as defined in Section 1.3, but it does apply to legal costs associated with such "Liabilities".

Diasonics contended that the 1% threshold is inapplicable to legal costs associated with Section 1.3 "Liabilities" because the exception in the last sentence of Section 9.2(c)(1) applies to such costs as well as to the "Liabilities".

Toshiba's characterization of Section 9.2 as one "of Byzantine complexity" is well-taken. A majority of the Panel concluded that Diasonic's interpretation is the correct one. The reference in the exception in the last sentence of Section 9.2(c)(1) is not solely to subparagraph (3) of paragraph 9.2(b) but rather to Section 9.2(b)(3). The reference as a whole is thus to "Damages arising from . . . the Liabilities as of the Closing. . . . " Hence, the 1% threshold does not apply to "Damages" that have as a component legal expenses associated with the defense of "Liabilities" that were assumed by Toshiba pursuant to Section 1.3.

III. FURTHER SUBMISSIONS BY THE PARTIES

Declaratory relief provisions of the award: The parties previously submitted their respective proposals for the wording of the portion of the final award setting forth declaratory relief relating to the claim of Diasonics. See the letter on behalf of the Panel dated January 28, 1993, paragraph 10.

Neither draft is fully responsive to the rulings made hereinabove. Counsel for Diasonics is therefore requested to draft a form of Award and submit it to counsel for Toshiba for approval as to form only. The draft shall contain alternative provisions respecting Diasonics' rights in the event that punitive damages should be awarded against Diasonics in any of the underlying cases.

If counsel are unable to agree on the form of the Award, each party shall submit to the Panel not later than April 19, 1993 its proposed form of award with an accompanying brief argument respecting the reasons to prefer one version over the other. Reargument of issues heretofore submitted to and decided by the Panel will be inappropriate.

Punitive Damages Issue: The plain words of Section 1.3 are sufficiently broad to include within the definition of assumed liabilities any award of punitive damages against Diasonics in one of the underlying tort actions. However, the question would remain Toshiba's agreement to indemnify Diasonics against such damages would be validated by Section 2274. The Panel desires further briefing by the parties on this issues [sic]. Such briefs shall be submitted to the Panel not later than April 19, 1993.

Dated: April 2, 1993.

/s/ Peter Anderson
Peter Anderson
Neutral Arbitrator
for a Majority
of the Panel

APPENDIX B

AMERICAN ARBITRATION ASSOCIATION

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Diasonics, Inc.

-and-

Toshiba America Medical Systems, Inc.

SECOND INTERIM DECISION

I. INTRODUCTION

The interim decision by a majority of the Panel dated April 2, 1993 ("initial interim decision") ruled upon most of the issues raised herein by the claim of DIASONICS, INC. ("Diasonics"). Respondent TOSHIBA AMERICA MEDICAL SYSTEMS ("Toshiba") thereafter advised the Panel that it was withdrawing its counterclaim.

This second interim decision will first address a procedural issue that was raised in the dissent to the initial interim decision by co-arbitrator Stallings dated April 2, 1993. The decision will then discuss the various issues that have been raised by the parties and remain to be decided. Finally, the Panel will make the determination required by Rule 43.

An Award consistent with the initial interim decision and the second interim decision will be made by a majority of the Panel.

All arguments presented by the parties have been considered by the Panel, whether or not discussed in this decision.

II. PREPARATION OF THE INITIAL INTERIM DECISION

Ordinarily, the internal procedures followed by an arbitration panel in the course of making its award are not revealed to the parties. However, co-arbitrator Stallings discussed in his dissent to the initial interim decision the procedure that was followed in rendering the decision. He argued that this procedure rendered this arbitration null and void. Dissent at 1-3.

This issue was not discussed in the initial interim decision. It appears from various communications from the parties that the issue may well be the subject of contentions in connection with any post-award confirmation proceeding. In order that there may be a meaningful record in such event, it is therefore appropriate to discuss the procedure that was followed.

The applicable statutes provide only that an award is to be made by the arbitrator or arbitrators and do not prescribe any specific procedures to be followed by the members of a panel in the course of their decision-making process. 9 U.S. Code Section 9; Code of Civil Procedure, Section 1283.4. Similarly, the Commercial Arbitration Rules only require that an award be made by a majority of the members of the arbitration panel. Rules 28 and 42. The procedures to be followed in a particular arbitration are thus left to the common sense and good judgment of the members of a panel, in accordance with the general rule that arbitration proceedings may be conducted informally so long as the hearing as a whole is fair. *Sapp v. Barenfeld*, 34 Cal. 2d 515, 520 (1949).

When all members of an arbitration panel are neutral arbitrators, it is the general practice, at least in the experience of the Neutral Arbitrator herein, for the members of an arbitration panel to schedule a meeting after the evidence has been taken and any post-hearing briefs have been received. A decision respecting the award in the arbitration is reached at this meeting. The collective evaluation of the controversy by two other neutral arbitrators is usually very helpful. Indeed, the practice of the American Arbitration Association is to appoint three neutral arbitrators in complex cases in order that different points of view and different real-life experiences may be brought to bear on the issues. Anderson, *Arbitrating Your First Case* 73 (The Practical Litigator, July 1990).

Hence, it may fairly be assumed that if three neutral arbitrators had been appointed in this arbitration, the Panel chair would have endeavored to schedule a meeting among the members of the Panel to discuss the issues prior to undertaking to draft the initial interim decision.

However, the parties to this arbitration did not elect to have the arbitration decided by three neutral arbitrators. Instead, the Asset Purchase Agreement provides that the arbitration panel shall consist of one neutral arbitrator and two party-appointed arbitrators.

California decisions recognize that party-appointed arbitrators are in reality another set of advocates for the positions of the appointing parties. *Tipton v. Systron Donner Corp.*, 99 Cal. App. 3d 501, 506 (1979); *Dinong v. Superior Court*, 120 Cal. App. 3d 300, 303 (1981); *Painters Dist. Council No. 23 v. Moen*, 128 Cal. App. 3d 1032, 1040 (1982). Thus, a recent case held that one who has acted as

a party-appointed arbitrator in an arbitration is deemed to have a substantial business relationship with the appointing party that must be disclosed if the arbitrator undertakes to act as a neutral arbitrator in a subsequent arbitration involving the appointing party. *Neaman v. Kaiser Foundation Hospitals*, 9 Cal. App. 4th 1170, 1176-1177 (1992).

Accordingly, the partiality of any party-appointed arbitrator is assumed in any California arbitration. Anderson, *supra* at 72.

In this arbitration, the parties appointed arbitrators who are distinguished and able attorneys. They have skillfully presented the positions of their appointing parties. On any issue of any significance, each co-arbitrator has consistently and faithfully presented arguments in favor of, and voted in favor of, his appointing party. Resolution of the conflicting arguments, and the casting of the deciding vote, has been made on each and every major issue by the Neutral Arbitrator.

The parties to the arbitration also retained very capable trial counsel. Their written and oral advocacy has been thorough and professional. Prior to the rendition of the initial interim decision, the issues were fully briefed. In addition, the Panel heard extensive oral argument. The argument was reported and the transcript was submitted to the Panel.

At the conclusion of oral argument, the Neutral Arbitrator considered several courses of action.

One course was to convene the members of the Panel and discuss the presentations that had been made by trial

counsel. In such event, it was obvious that each party-appointed arbitrator would advocate the position of his appointing party, reiterate the arguments of counsel for his appointing party, and vote in favor of his appointing party on all material issues.

The other course was for the Neutral Arbitrator to draft a proposed opinion and distribute it to the two party-appointed arbitrators for their comments. In such event it was obvious that one party-appointed arbitrator would concur and the other would dissent.

The Neutral Arbitrator believed that he had made it clear to both party-appointed arbitrators that he was considering these two alternatives. Co-arbitrator Dillingham apparently so understood. Co-arbitrator Stallings has strongly stated that he did not have this understanding. There can be no doubt respecting his sincerity. For whatever reason, there was a failure of communication for which the Neutral Arbitrator must accept at least partial responsibility.

The Neutral Arbitrator elected to take the second course of action. He did so for several reasons. The written and oral advocacy of both trial counsel was outstanding. To the extent that memory of the oral argument faded, a transcript was available and it was read. Another round of oral argument by another pair of advocates was deemed unnecessary.

The Neutral Arbitrator also had in mind his personal experience some decades ago as a law clerk to a justice on the California Supreme Court. The practice of the Court at that time was to assign cases to individual justices

prior to oral argument. The assigned justice with whatever useful assistance might be forthcoming from his law clerks prepared a calendar memorandum that was distributed to the other members of the Court prior to argument. Such memoranda were frequently in the form of a draft opinion that set forth a recommended disposition of the case.

The actual voting of the justices, of course, took place after oral argument. Frequently, the calendar memorandum became the opinion of the Court with relatively minor changes. No one involved ever felt that there was anything in the least improper in drafting an opinion prior to oral argument and prior to any consultation with the other justices. By contrast, here the decision-making process did not commence until after oral argument. Additionally, the other Panel members were not impartial. Hence, it appeared proper to emulate the practice of the Neutral Arbitrator's early mentors.

The Neutral Arbitrator carefully considered the briefs and the oral argument, as heard and transcribed. A draft of the initial interim decision was prepared. It was essentially in favor of Diasonics. The draft was then submitted to the party-appointed arbitrators. Submission of the draft served two purposes. One was to obtain the concurrence required by Rules 28 and 42. The other purpose was to be sure that no argument had inadvertently been overlooked or misunderstood. Thus, it seemed to the Neutral Arbitrator, both party-appointed arbitrators would have an opportunity to participate in the decision-making process consistent with their partiality.

Predictably, the co-arbitrator appointed by Diasonics concurred in the conclusions set forth in the draft and the co-arbitrator appointed by Toshiba dissented. Unexpectedly to the Neutral Arbitrator, co-arbitrator Stallings vigorously argued that the procedure followed herein rendered the arbitration null and void.

With the benefit of hindsight, the Neutral Arbitrator sincerely regrets that he did not notify the co-arbitrators in writing that he had elected to follow the second course of action. This would have avoided any element of surprise and any embarrassment to co-arbitrator Stallings in his relationship with Toshiba.

Nevertheless, no prejudice to Toshiba occurred. Its position on every issue was thoroughly and ably presented by Toshiba's trial counsel. Distribution of the draft to the party-appointed arbitrators provided assurance that Toshiba's contentions had been understood. Co-arbitrator Stallings' dissent is skillful and comprehensive. However, all the arguments therein had previously been presented by Toshiba's trial counsel, albeit in another format, and had been carefully considered by the Neutral Arbitrator. Toshiba was entitled to have its arguments presented once by its advocates. It was not denied a fair hearing because they were not presented to the Neutral Arbitrator a second time by another of its advocates prior to preparation of the draft.

A subsequent development merits discussion.

In deference to the concerns so strongly raised by co-arbitrator Stallings, a different procedure was followed by the Panel with respect to the issues that are the subjects of Parts III and IV hereof. Counsel for the parties

submitted briefs fully setting forth the contentions of the parties. The Panel then met to discuss the issues. Counsel waived oral argument, thereby eliminating the possibility of duplicative oral presentations on behalf of a party.

The presentations by the party-appointed arbitrators at the meeting of the Panel were all that would be expected of attorneys with their skill, experience and professional success. Further, at the meeting of the Panel co-arbitrator Stallings on behalf of his appointing party presented a thoughtful analysis of the choice of law issue that is discussed below in Part IV hereof. At the request of the Neutral Arbitrator, this issue was further developed in written submissions by each co-arbitrator on behalf of his appointing party.

However, following this procedure in the latter instance does not prove that failing to follow it in a former instance was an error. Each party-appointed arbitrator played the role of an advocate for his appointing party. Had counsel elected to present oral argument, such arguments presumably would have been made with the same skill and thoroughness as the earlier oral advocacy. The meeting of the Panel was a viable alternative to oral argument. However, there was no indication that duplicative oral presentations were necessary in order adequately to present the position of a party.

The dissent to the initial interim decision also criticizes certain communications by the Neutral Arbitrator. Dissent at 1-2. The circumstances of those communications have been fully disclosed by everyone involved. The American Arbitration Association considered those

disclosures and declined to disqualify the Neutral Arbitrator. No more need be said here other than respectfully to record the total disagreement of the Neutral Arbitrator with the dissent's characterization of these innocuous communications.

III. PUNITIVE DAMAGES ISSUE

A request was made in the initial interim decision for further briefing respecting the punitive damages issue. 7-8, 18. The parties have done so and the issue is ripe for decision.

A majority of the Panel ruled that, in view of Section 2774 of the Civil Code and the sweeping language of Section 1.3 of the Asset Assumption Agreement, Toshiba is required to indemnify Diasonics against any award for compensatory damages, including awards of such damages based on fraud claims pursuant to Civil Code Sections 3333 and 3343 and the equivalents thereof in other states. Initial interim decision at 7.

A more difficult issue is presented with respect to indemnification for punitive damages. Under California law, an award of punitive damages is made "for the sake of example and by way of deterring defendant". Civil Code Section 3294(b). Thus, the Supreme Court recently held that evidence of the financial condition of the defendant is required as a basis for punitive damages because "the quintessence of punitive damages is to deter future misconduct by the defendant". *Adams v. Murakami*, 54 Cal. 3d 105, 110 (1991).

It is clear that California will not permit indemnification against an award of punitive damages based on post-agreement misconduct of the indemnitee. *Stonewall Surplus Lines Ins. Co. v. Johnson Controls, Inc.*, 14 Cal. App. 4th 637, 642-643 (1993), and cases cited therein. That would not occur here. Any misconduct of Diasonics that could give rise to an award of punitive damages took place prior to the acquisition by Toshiba and the effective date of the Asset Assumption Agreement.

Diasonics and Toshiba are substantial business entities. They were represented by competent counsel in the negotiations preceding execution of the Asset Assumption Agreement. In the course of those arms length negotiations, Toshiba obligated itself to indemnify Diasonics for liabilities. The sweeping language of the indemnity encompasses any award of punitive damages for pre-agreement misconduct. Contractually shifting the burden of paying punitive damages based on pre-agreement misconduct of the indemnitee is permissible under Section 2774. Initial interim decision at 7.

The narrow issue before the Panel is whether, not withstanding the broad language of Section 2774, California law would permit Toshiba to escape its contractual obligation to Diasonics because such indemnification would serve to defeat the deterrent purpose of Section 3294(b) in that the pain of payment would not be borne by the wrongdoer.

Toshiba relies principally upon *Peterson v. Superior Court*, 31 Cal. 3d 147 (1982). An earlier decision of the Supreme Court had held that punitive damages could be recovered by a person injured by an intoxicated driver.

Peterson held that this rule would be applied retroactively. 31 Cal. 3d at 147. In response to an argument that to do so would negate insurance coverage, the Court stated, 31 Cal. 3d at 158:

> "There are two distinct reasons why indemnification of punitive damages is prohibited in California. First is the public policy rationale against diluting the deterrent effect of punitive damages by allowing the impact of the penalty to be shifted to the insurer. This justification applies whatever the basis for the punitive damages award. The second reason is applicable only when the basis for the punitive damages is a willful act of the defendant. When the defendant commits an intentional tort, the prohibition of [Insurance Code] section 533 presents an additional reason for disallowing indemnification of the punitive damages, as well as indemnification of the remainder of the plaintiff's recovery. However, because the situations in which punitive damages are allowed include more than just those resulting from intentional torts, indemnification of the entire damage award is not always precluded."

In *Peterson* the Court was discussing insurance coverage for future wrongful acts. In a non-insurance context, such indemnification would be invalidated by Section 2773. *Peterson* did not address the issue whether indemnification for punitive damages would be permitted pursuant to an agreement that came into effect *after* the commission of the wrongful act. However, the Court's broad admonition "against diluting the deterrent effect of punitive damages to be shifted to the insurer" could be

interpreted as applicable both to prospective and to retroactive indemnification agreements.

Diasonics cited two California cases imposing on successor corporations the obligation to pay punitive damages assessed by reason of the misconduct of a predecessor corporation. As Toshiba points out, in each instance the obligation was imposed by reason of principles of corporate law. *Moe v. Transamerica Title Ins. Co.*, 21 Cal. App. 3d 289, 303-304 (1971) (corporation formed by consolidation or merger is answerable for the debts and liabilities of the constituent corporations, including liability for punitive damages); *Marks v. Minnesota Mining & Manufacturing Co.*, 187 Cal. App. 3d 1429, 1434-1437 (1986) (acquisition by parent of assets of subsidiary had the consequences of a statutory merger including the assumption of liability for punitive damages).

Judge Rea of the Central District recently analyzed the California cases evaluating the circumstances under which a successor corporation may properly be held liable for a punitive damage award arising from the intentional acts of the predecessor corporation. *Certain Underwriters of Lloyd's v. P.S.W. Airlines*, 786 F. Supp. 867 (C.D. Cal. 1992).

In the *P.S.W. Airlines* case, US Air had purchased PSA through a large-scale purchase of PSA stock. Lloyd's had insured an insurance policy in favor of PSA. A former employee of PSA sued PSA and US Air in State court and recovered a verdict assessing substantial punitive damages. Lloyd's sought declaratory relief in Federal court respecting its obligations under the policy. The subject opinion dealt with Lloyd's motion for partial summary

judgment on the issue of its coverage for the punitive damages award against PSA.

To defeat the Lloyd's motion, US Air invoked the line of California cases holding that an insured can be indemnified when its liability for punitive damages is vicarious and it is only required to pay punitive damages because of the employee's wrongdoing. 786 F.Supp. at 869. It therefore became necessary for the Court to decide whether US Air had successor or vicarious liability.

Judge Rea stated (page 870)

> "The courts have failed to establish a uniform test to evaluate when a successor corporation can properly be held liable for a punitive damage award arising from the intentional acts of the predecessor corporation. The courts have developed two tests, namely, the mere continuation test and the form of the merger test.
>
> ". . . .
>
> "Although the 'mere continuation' test has merit, the test fails to give adequate weight to the punishment purpose of punitive damages. This Court believes that the mere continuation test should be modified. Instead of focusing on whether the successor entity is the mere continuation of the predecessor, the focus will be on whether the predecessor entity makes up a 'significant and identifiable part' of the successor entity. If the predecessor does make up a significant and identifiable part of the successor entity, the successor can fairly be punished for the acts of the predecessor. The reason is twofold. First, so long as the predecessor retains an identifiable existence in the successor entity, that portion of the successor entity remains a wrongdoer and

should be punished. In addition, the successor would have paid a lower price when the successor purchased the predecessor. This lower price reflects the potentiality of any and all lawsuits. Therefore, the successor is not being unduly punished or harmed."

After analyzing the *Marks* and *Moe* decisions, Judge Rea further stated (pages 873-874):

"The Court is of the opinion that both the 'significant and identifiable part' and 'form of the merger' tests should be considered because either of these tests may be applicable. For instance, if the successor consists in significant part of the predecessor, such that the predecessor's unique existence has not been eradicated, a court can properly punish the predecessor by punishing the successor regardless of the form of the merger.

"In addition, if the successor corporation subsumed the predecessor in a form which recognized that the successor was assuming all the liabilities of the predecessor, the successor cannot claim that it was unfairly punished by the acts of the predecessor because the successor was aware of that possibility when the successor subsumed the predecessor. This awareness disallows indemnification regardless of whether the predecessor makes up a 'significant and identifiable part' of the successor."

The Court applied the test and determined that US Air had successor liability because it acquired PSA subject to PSA's debts and liabilities. It ruled that under these circumstances, the successor liability of US Air was not the functional equivalent of vicarious liability and US Air

had not brought itself within the exception. 786 F. Supp. at 871.

Judge Rea concluded (786 F. Supp. at 871):

> "This holding is consistent with the policy behind punitive damages. Punitive damages are designed to punish the wrongdoer and deter future harm. US Air argues that it was not the wrongdoer, just as an employer is not the wrongdoer when the employer is held vicariously liable for the actions of its employee. The distinguishing factor in this case is that US Air was on notice that it was purchasing PSA subject to the liabilities of PSA and is unable to claim innocence of PSA's actions. Thus, as the successor entity, US Air is responsible as the wrongdoer, in the sense that the predecessor may have committed some wrongdoing and thereby agreed to assume any liability therefore. Using this analysis, the proper party is being punished."

The *P.S.W. Airlines* case was not an action by PSA against US Air to enforce a contractual obligation of US Air to indemnify PSA. It is thus not directly in point. However, the Court was clearly of the view that the burden of punitive damages could properly be imposed on a successor corporation, for the reasons set forth in the extensive quotations from the opinion above. Judge Rea's ultimate conclusion that "the proper party is being punished" demonstrates that the Court would have ruled that US Air was required to indemnify PSA.

It was previously observed that decisions in the Federal judicial system are not California precedents. Initial interim decision at 9. Further, the *P.S.W. Airlines* case is

not an appellate opinion. However, Judge Rea's scholarly decision is entitled to the same weight that would be given to a law review article or other secondary authority reviewing the decisions and predicting the future course of California jurisprudence.

The Asset Purchase Agreement requires the Award to be made in accordance with California law. In the absence of any California case directly in point, the Panel must perforce make its own determination respecting California law. A majority of the Panel concluded that Judge Rea's analysis in *P.S.W. Airlines* is predictive of California law.

Toshiba acquired a significant and identifiable division of Diasonics that conducted the segment of the business that is the source of the underlying tort actions wherein there is a possibility of an award of punitive damages. Toshiba assumed the tort liabilities in the Asset Purchase Agreement, including any liability to pay punitive damages. Hence, application of the *P.S.W. Airlines* rationale to the facts of this arbitration leads to the conclusion that requiring Toshiba to comply with its contractual obligation will not violate California public policy. It is therefore not necessary to determine whether Toshiba would have been required under California law to indemnify Diasonics if it had contracted to do so, but were not a successor corporation.

It bears noting that the Fourth Circuit has recently held that a successor corporation that has assumed tort liabilities of a predecessor may be required to bear the burden of punitive damages. *City of Richmond, Va. v. Madison Management Group*, 918 F. 2d 438, 455-456 (4th

Cir. 1990) and cases cited therein. *City of Richmond* did not, of course, involve a determination of California law, but it is reassuring that there is respectable authority for the proposition that indemnification against an award of punitive damages for pre-agreement misconduct is not against public policy.

Toshiba is required to indemnify Diasonics against any award of punitive damages in the underlying tort actions.

IV. THE CHOICE OF LAW ISSUE

A majority of the Panel ruled in the interim initial decision that, in view of Section 2774 of the Civil Code, Section 1.3 of the Asset Purchase Agreement was enforceable under California law with respect to underlying tort actions involving fraud claims. Page 7.

By its memorandum dated June 25, 1993, Toshiba requested reconsideration of this ruling on the ground that indemnification would contravene the laws of the jurisdictions in which fraud issues had been raised in the underlying tort actions. The Panel ruled that the issue would be reconsidered. The parties submitted additional briefs directed to the issue.

In the initial interim decision a majority of the Panel deemed California law to be controlling because Section 10.12(a) of the Asset Purchase Agreement provided:

> "The terms of this Agreement shall be governed by the laws of the State of California."

Choice of law provisions in contracts are enforced in California when the chosen state law has a substantial

relationship to the parties or their transaction, or there is any other reasonable basis for the parties' choice of law. *Nedlloyd Lines B.V. v. Superior Court*, 3 Cal. 4th 459, 466 (1992). It is clear that both of the *Nedlloyd* tests are satisfied here.

Toshiba contends that *Nedlloyd* is not dispositive. Toshiba's argument, as more fully developed by co-arbitrator Stallings, is that under the circumstances here there is an exception to the usual California rule that the parties' choice of law provision in an agreement is enforced.

Diasonics contends that Toshiba's argument should be disregarded because it is inconsistent with Toshiba's position during this arbitration that California law governs the scope of its indemnity to Diasonics.

However, the Neutral Arbitrator does not so view Toshiba's position.

The initial interim decision determined at a minimum that if a tort action were pending in California, Toshiba must indemnify Diasonics whether or not the plaintiff in the underlying action sought recovery under fraud theories. The decision did not specifically address the question whether Toshiba had a similar obligation if the underlying tort action were pending in another state ("Forum X"), the plaintiff therein sought recovery under a fraud theory, and the substantive law of Forum X would not have permitted indemnification under such circumstances. The parties did not raise the issue, and it was not detected by the Neutral Arbitrator or the co-arbitrators. However, it was probably implicit in the language of the decision that indemnification would be required under

such circumstances and the Award would have so provided if the issue had never been raised.

The Panel is required by the Asset Purchase Agreement to apply California law. However, "California law" includes California conflict of law principles as well as California substantive law. Once identified, the issue raised by Toshiba is not determinable merely by deciding what a California court would do if the underlying tort action were in California.

Diasonics points out that California requires that conflict of law issues be raised in a timely fashion. *Hurtado v. Superior Court*, 11 Cal. 3d 574, 581 (1974). But what is "timely"? Obviously, it would have most desirable for Toshiba to have raised the choice of law issue much earlier in this proceeding. If Toshiba had done so, the issue could have been briefed and resolved in the initial interim decision. With hindsight, even Toshiba probably would have to concede this much.

However, during the earlier part of this proceeding the focus of everyone concerned was on the proper interpretation of the Asset Purchase Agreement. If Toshiba had prevailed on that issue, the conflict issue would not have been reached. An arbitration proceeding certainly should be resolved in a timely fashion. However, an arbitration proceeding should also give the parties a full opportunity to present their arguments on a critical issue which may affect the ultimate outcome of the arbitration. In view of the amounts at stake and all of the circumstances, the Neutral Arbitrator in the exercise of his discretion does not feel required by *Hurtado* to decline to consider Toshiba's contentions.

The Toshiba argument has two major premises.

The first premise is that in some if not all of the states where the underlying tort actions are pending, an agreement to indemnify a tortfeasor for past fraudulent acts would be unenforceable as against public policy.

The second Toshiba premise is that California would under such circumstances yield to the policy of the state where the tort action is pending and would not permit Diasonics to obtain contractual indemnification.

Each premise will be examined in turn.

Toshiba's first premise is not supported by the cases that it has cited to the Panel. The cases involved common law principles of indemnification and contribution, agreements that purported to indemnify a party against the consequences of future wrongful conduct, or the special policy considerations applicable to violations of the Federal securities laws. No case was cited by Toshiba holding that the state where a tort action is pending would forbid one of the parties to the tort action to obtain indemnification for past conduct pursuant to a contract that is valid and enforceable under the law of the state that was selected by the parties and that has a substantial relationship to the subject matter of the contract.

Toshiba's second premise will be independently examined. It will be assumed *arguendo* for purposes of this part of the analysis that the law of a state where an action is pending ("Forum X") would have prevented Diasonics from enforcing the indemnification provisions of the Asset Purchase Agreement if the agreement were governed by the law of Forum X.

The Supreme Court stated in *Nedlloyd* that it would apply the principles set forth in Section 187 of the Restatement Second Conflict of Laws. 3 Cal. 4th at 464-465.

Section 187 provides:

"(1) The law of the state chosen by the parties to govern their contractual rights and duties will be applied if the particular issue is one which the parties could have resolved by an explicit provision in their agreement directed to that issue.

"(2) The law of the state chosen by the parties to govern their contractual rights and duties will be applied, even if the particular issue is one which the parties could not have resolved by an explicit provision in their agreement directed to that issue, unless either

"(a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or

"(b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of Section 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.

"(3) In the absence of a contrary indication of intention, the reference is to the local law of the state of the chosen state."

Toshiba argues that under California law the exception set forth in Section 187(2)(b) is applicable here.

Two conditions must be met. First, the hypothetical Forum X must have "a materially greater interest than the chosen state in the determination of the particular issue". Second, Forum X is required "under the rule of Section 188 [to] be the state of the applicable law in the absence of an effective choice of law by the parties".

The first condition requires a balancing of the interests of Forum X and the interests of California.

The Asset Purchase Agreement shows the close connection of the underlying transaction to California. Toshiba is a California corporation. Preamble. Toshiba acquired the shares of California corporations that were subsidiaries of Diasonics. Third "Whereas". The agreement was performed by a closing which took place in California. Section 2.1. All notices and communications were sent to California addresses. Section 10.11. California law governed the relationship of the parties and any arbitration was to take place in San Francisco, California. Section 10.12.

Similar circumstances were present in *McMullan & Son, Inc. v. United States Fid. & Guar. Co.*, 103 Cal. App. 3d 198 (1980). In *McMullan,* a California corporation purchased an insurance contract in California from a California insurance broker. A claim against the insured arose in connection with a construction project in Florida and Florida litigation ensued. There was subsequent litigation in California respecting the rights and obligations of the insured and the insurer under the insurance contract. The Court had to determine whether to apply the law of

Florida, the state where the underlying action was brought, or the law of California, the state where the parties entered into the insurance contract. The Court held that California law applied, stating (103 Cal. App. 3d at 205):

> "California, not Florida or Maryland, was the place of contracting, the place of negotiation of the contracts. The place of performance was not specified, yet McMullan was a resident of California and Fidelity a resident of Maryland, and Fidelity did business in California. The Fidelity contacts with Maryland were not significant with respect to these contracts since Fidelity did business on a national scale. Fidelity knowingly dealt with residents of the various states and voluntarily subjected itself to the contract laws of those states.
>
> "Moreover, California has many interests in having its law applied in this case. California is the forum state. Since the contract was made between a California resident and a corporation doing business in California, *California has an interest in seeing that such contract is enforced* according to the law where it was made." (Emphasis added).

Here, the indemnification agreement is enforceable under California law. Civil Code, Section 2774; interim initial decision at 7. Toshiba has not demonstrated that the interest of Forum X is "fundamentally greater" than the interest of California in enforcing the agreement according to its terms.

The second condition in Section 187(b)(2) requires reference to Section 188 of the Restatement. It provides:

"(1) The rights and duties of the parties with respect to an issue in contract are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the transaction and the parties under the principles stated in §6.

"(2) In the absence of an effective choice of law by the parties (see §187), the contacts to be taken into account in applying the principles of §6 to determine the law applicable to an issue include:

(a) the place of contracting,

(b) the place of negotiation of the contract,

(c) the place of performance,

(d) the location of the subject matter of the contract, and

(e) the domicile, residence, nationality, place of incorporation and place of business of the parties.

"These contacts are to be evaluated according to their relative importance with respect to the particular issue.

"(3) If the place of negotiating the contract and the place of performance are in the same state, the local law of this state will usually be applied, except as otherwise provided in §§189-199 and 203."

Each of the five Restatement conditions favors the application of California law here. California has the "most significant relationship" to the subject matter of the agreement and this arbitration.

Accordingly, Toshiba has not been able to satisfy either condition of the exception set forth in Section 187(2)(b).

Toshiba relies upon *Ashland Chemical Co. v. Provence*, 129 Cal. App. 3d 790 (1982). However, *Ashland* is consistent with the foregoing analysis.

In *Ashland*, a California corporation and two California residents executed a promissory note payable to a Kentucky corporation. The note provided that it was to be governed by and construed in accordance with Kentucky law. The payee sued on the note in California. If the California statute of limitation were applied to the action, it was barred; if the Kentucky statute of limitation controlled, the action was timely. The trial court applied the California statute.

The Court of Appeal affirmed, on the ground that application of Kentucky law would violate the protective policy of the forum, California. The Court said (129 Cal. App. 3d at 795):

> "We hold the parties to a contract may not select the law of a disinterested state to govern their agreement when applying that law would be contrary to the public policy of the state whose law would ordinarily be applied under choice of law principles – in this case California."

Here, the parties selected the law of an interested state, California. As stated in *McMullan*, California has an interest in applying its law to the contract between Toshiba and Diasonics. After application of the Section 188 factors, California is "the state whose law would

ordinarily be applied under choice of law principles". Hence, *Ashland* does not support Toshiba's position.

Toshiba further contends that the Full Faith and Credit Clause and the Due Process Clause require California yield to the (assumed) policy of Forum X that forbids indemnity.

Of course, a California court would be bound by decisions of the United States Supreme Court interpreting the Constitution of the United States. 7 Witkin, Summary of California Law [9th Ed.], Constitutional Law, Section 92, and cases cited. This principle is part of the "California law" that the Panel is required to apply under the Asset Purchase Agreement.

The most recent United States Supreme Court decision cited by the parties is *Allstate Ins. Co. v. Hague*, 449 U.S. 302 (1981). It held that a state may choose to apply its own laws if there are significant contacts with the forum state and application of its laws is neither arbitrary or substantially unfair. 449 U.S. at 320, 326. Those conditions are met here.

Toshiba relies upon *Home Ins. Co. v. Dick*, 281 U.S. 397 (1930), a case of somewhat ancient vintage. *Hague* stated that *Dick* stands "for the proposition that if a State has only insignificant contact with the parties and the occurrence or transaction, application of its law is unconstitutional". 449 U.S. at 310-311; see *Dick*, 281 U.S. at 408, note 5. Here, California has significant contacts with the parties and the transaction that is the subject of the Asset Purchase Agreement.

The other case cited by Toshiba, *Hughes v. Fetter,* 341 U.S. 609 (1951), involved a refusal by a forum state to enforce a right created by the law of another state. 341 U.S. at 612. That is not the situation here, where the issue is whether California would decline to enforce a right created by a contract that is valid under California law. See by analogy *Hughes,* 341 U.S. at note 10.

Toshiba has not cited any case holding that the United States Constitution requires a forum state with significant contacts with the parties to decline to enforce a contract, valid under the laws of the forum, by reason of common law principles of another state that also has contacts with the parties. A majority of the Panel does not believe that there is such a constitutional requirement.

Toshiba argues that the choice of law provision in the Asset Purchase Agreement is not applicable to tort claims.

It is true that a choice of law provision in a contract governs *ex contract* disputes between the contracting parties and does not govern *ex delicto* disputes between them. *Consol. Data Term. v. Applied Digital Data Systems,* 708 F. 2d 385, 390, n.3 (9th Cir. 1983) (discussing California choice of law decisions). However, that rule does not assist Toshiba. Diasonics' claim against Toshiba is based on the indemnity provisions of the Asset Purchase Agreement. Diasonics has not made a tort claim against Toshiba.

In summary, no basis has been shown by Toshiba for a departure from the *Nedlloyd* rule. The parties chose in their agreement to make California law applicable. The

indemnification provisions on the Asset Purchase Agreement are valid under California law. They are applicable whether the underlying tort actions are pending in California or in other states.

V. THE FORM OF THE AWARD

The parties were requested to endeavor to agree upon a form of an Award embodying the rulings in the initial interim decision. Decision at 18. The parties were unable to do so. Each party submitted a draft of the Award and each party submitted comments on the draft submitted by the opposing party. Of course, it is understood that such participation by Toshiba in the determination of the wording of the final Award was at the specific request of the Panel and that such participation may not be deemed to be a waiver of Toshiba's objections to the rulings that are embodied in the Award.

The draft submitted by Diasonics will be considered first. Toshiba's objections to the draft will be discussed in turn.

Toshiba's first objection is that the Diasonics draft "consists largely of a revision of the 'analysis' portion of the opinion set forth in the interim ruling". No prejudice to Toshiba appears therefrom and the objection is overruled.

Toshiba's second objection is that the Diasonics draft "fails to declare that respondent has the right to take over the defense of claimant on a case by case basis".

Toshiba did not provide a citation. Apparently the reference is to Section 9.3 of the Asset Purchase Agreement and the detailed procedures respecting indemnification set forth therein.

The Award will not and cannot rewrite the terms of the Asset Purchase Agreement. Rather, the Award will interpret the provisions of the Agreement that were the subject of this arbitration. Accordingly, there is no need for the Award to restate all of the various complex provisions of the Asset Assumption Agreement. The provisions of Section 9.3 remain in force and there is no need to make the change requested by Toshiba.

Toshiba's third objection is that Diasonics draft "fails to declare that respondent has the right to direct how claimant conducts its defense on a case by case basis, whenever respondent does not take over the defense".

Again, Toshiba did not provide a citation. Apparently, the objection reflects Toshiba's interpretation of Section 9.3 of the Asset Purchase Agreement. The issue whether that interpretation is or is not correct has not been briefed by the parties and submitted to the Panel for decision. It is inappropriate under these circumstances to include the language requested by Toshiba.

Toshiba's fourth objection is that the draft:

> "purports to rule on all guarantees irrespective of their terms and conditions, including restrictions on assignability, etc., which may be applicable to them and the facts and circumstances concerning which were not presented to the

> panel. The panel does not have such hypothetical guarantees before it and has no basis on which to rule concerning such hypotheticals."

Toshiba's objection is meritorious. Paragraph 7 of the Diasonics draft provides:

> "In addition to the Diasonics Guaranty and Diasonics Shortfall Agreement, Toshiba assumed liability and owes indemnity with respect to Diasonics' other guarantees relating to the MRI Division. Toshiba's assumption of such liabilities is valid regardless of whether consent or any other approval to Diasonics' assignment to Toshiba and/or Toshiba's assumption of such guarantees was obtained from the party to whom such guarantee(s) is owed or any other person or entity".

As illustrated by the facts of the underlying action in the *Lenox Hill* case, guarantees relating to the MRI Division may have been made in various factual contexts that could affect Toshiba's liability. The Panel ruled against Toshiba with respect to the *Lenox Hill* case. Initial interim decision at 12-14. Other guarantee situations with different facts could lead to a different conclusion. It may well be that Toshiba has an indemnity obligation with respect to all of Diasonics' other guarantees relating to the MRI Division. However, on the record of this arbitration, an unqualified declaration to such effect would be unfair to Toshiba.

Toshiba's next objection is that the Diasonics draft "fails to state that the counterclaim was withdrawn without prejudice for the reasons set forth in [counsel's] letter of April 13, 1993.

The Diasonics draft states, "Toshiba has withdrawn its counterclaim". It does not specify whether such withdrawal is with or without prejudice. From other communications by the parties, it appears that if the counterclaim were to be reasserted in a subsequent arbitration, Toshiba would contend that it could do so and Diasonics would contend that Toshiba is barred from doing so. This issue is not before this Panel. The draft language accurately states what occurred and does not purport to rule upon the legal effect of the withdrawal. The objection is overruled.

Toshiba also submitted a draft and Diasonics objected thereto.

Diasonics' first objection is that the Toshiba draft is limited to a declaration of the parties' rights and obligations with respect to the pending underlying actions but does not provide any guidance with respect to future actions that may be filed.

The objection is sustained to the extent that the final Award will set forth the conclusions in the initial interim decision and thereby provide guidance whenever similar issues should arise in future underlying actions. However, as noted above in discussing Toshiba's objections with respect to the guarantee issue, there may well be future underlying actions that raise issues that were not involved in this arbitration.

Diasonics' next objection is that the Toshiba draft does not clearly state that Toshiba must indemnify Diasonics for its costs and expenses in the underlying actions that may be incurred prior to the time that Toshiba should assume the defense of these actions with

counsel acceptable to Diasonics. Diasonics included language to such general effect in its draft (page 5, lines 11-15) and Toshiba did not object thereto. This wording will be included in the final Award.

Diasonics' third objection is that Toshiba's draft makes Diasonics' right to indemnity conditional on Diasonics' duty to "cooperate" with Toshiba. Diasonics argues that this issue was not before the Panel. Diasonics is technically correct and the Award will be silent on this subject. However, the parties are reminded that while the Award resolves disputes between the parties respecting the interpretation of the Asset Purchase Agreement, all provisions of that Agreement remain in full force and effect. Hence, a failure to refer in the Award to any particular provision of the Agreement does not imply that such provision may be disregarded by a party.

Diasonics' final objection is that the Toshiba draft "does not reflect the Panel's ruling that Toshiba assumed liability for, and agreed to indemnify Diasonics against, *all* of the causes of action alleged in the underlying actions, not merely those grounded in tort law". Emphasis in original. Toshiba responded by arguing that "the issue of non-tort claims is not part of this arbitration".

The Diasonics draft provides that Toshiba shall indemnify Diasonics with respect to six identified pending actions. Toshiba did not object to this language. At least some of these actions involve breach of contract claims. See Exhibits F, G and H in the Appendix to the Opening Submission of Diasonics.

The parties discussed the underlying actions in their submissions to the Panel. See, for example, Diasonics Opening Submission dated January 11, 1993 at 8-13 and Toshiba's Preliminary Conference Memorandum dated January 19, 1993 at 4-10. It was clear that Diasonics sought indemnification with respect to all claims asserted in those actions. Toshiba had a full opportunity to contest Diasonics' showing. It is too late now to endeavor to draw a distinction between the tort and contract claims in the underlying actions.

Diasonics' objection is therefore sustained. The final Award will incorporate Diasonics' wording with respect to the identified pending actions.

A further observation is appropriate. It is possible that in future actions contract claims may be asserted that involve factual situations substantially dissimilar to those in the underlying actions that were the subject of the arbitration. In such event, as discussed above in connection with Toshiba's fourth objection to the Diasonics draft, the final Award will not imply that Toshiba must indemnify Diasonics for all contract claims irrespective of the circumstances.

The final Award will take into consideration the language submitted by both parties and will reflect the foregoing rulings. In addition, of course, the final Award will take into account the rulings of a majority of the Panel in this second interim decision.

The Panel and the parties have invested a great deal of time and effort in the resolution of the issues raised in this arbitration. New issues may arise that were not

involved in this proceeding. Hence, it may not be possible to solve every problem that may arise in the future respecting the critical provisions of the Asset Purchase Agreement. However, it is the earnest hope of the Panel that the final Award will be in a form that will at least minimize any need to resort to future arbitration proceedings on this subject.

To that end, the Panel will submit its revised draft of the Award to the parties and give them a final opportunity to comment thereon prior to the formal rendition of the Award pursuant to Rule 42.

VI. DISCLOSURE OF THE INITIAL INTERIM DECISION

Counsel submitted several letters in May and June 1993 respecting an alleged improper disclosure by Diasonics of the initial interim decision. Diasonics disputed the allegations of Toshiba and an evidentiary hearing has not been held.

The Panel met with counsel on June 11, 1993 to discuss the disposition of the remaining issues to be decided in this arbitration. See the Panel's letter of May 26, 1993, forwarded by the Association to the parties on May 28, 1993. Counsel did not indicate any desire at the June 11th meeting further to pursue the disclosure issue, and the matter is considered by the Panel to be moot.

VII. RULE 43 DETERMINATION

Rule 43 requires the Panel to provide in the Award for the assessment of the arbitration fees, expenses and compensation.

Diasonics ultimately prevailed on the major issues in this arbitration. However, the arbitration presented complex issues of law. Toshiba was substantially justified in asserting its position. The arbitration was certainly hard fought, but there was no misconduct by either party.

The Award will provide that each party will bear its own expenses, and that the administrative fees and expenses of the American Arbitration Association, and the compensation and expenses of the Neutral Arbitrator, shall be divided equally between Diasonics and Toshiba.

Dated: December 6, 1993.

/s/ Peter Anderson
Peter Anderson
Neutral Arbitrator
for a Majority
of the Panel